THE DUAL SYSTEM OF STABILISATION

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BY

J. TAYLOR PEDDIE

ENLARGED SECOND EDITION

MACMILLAN AND CO., LIMITED
ST. MARTIN'S STREET, LONDON
1931

PRINTED IN GREAT BRITAIN

To

EDMUND WILLIAM JANSON

IN COMMEMORATION OF
TWENTY-FIVE YEARS'
LOYAL FRIENDSHIP

PREFACE TO SECOND EDITION

SINCE I tendered evidence to the Committee on Finance and Industry last June on behalf of the Federation of Master Cotton Spinners' Associations, Ltd., I have, as a result of queries put to me by economists and bankers, elaborated and perfected 'The Dual System of Stabilisation.' The new work was embodied in a supplementary memorandum which was submitted to the Committee on Finance and Industry last February. In view of its importance the memorandum was circulated to the members of the Committee for consideration. The new work is now embodied in this edition.

From the industrial and sociological points of view, the 'Dual System' is the most important discovery yet made in the science of money. It is not only practical, but it fully accords with sound banking principles. In this connection a leading Australian banker writes me as follows :

> Regarding your suggestions in connection with the 'Dual System of Stabilisation' as far as Australia is concerned, I am of the opinion that were a Central Reserve Bank to be established in its entirety and legislation introduced whereby the Commercial Banks would re-discount their bills with the Central Institution. your scheme would work eminently. This would enable the Central Bank to control the ratio as between deposits and cash held by the Commercial Institutions, and incidentally, obviate the necessity of the Trading Banks holding large reserves to meet seasonal demands.

The new chapters I have added to this book by way of amplification are Chapters III, XV, XIX, XX, XXI, XXV, XXVII, XXVIII, XXIX, and I have added notes to Chapters IX, XII and XXIII. I have also made slight modifications to the old text where necessary, so as to obtain uniformity in the general theme. In its

new form the book should prove useful as a textbook on the science of money.

I have also re-written the best part of the chapter on Agriculture, as I do not now support the plea for the payment of subsidies on the cereal crops. My further research work has proved the payment of subsidies, directly or indirectly, to be undesirable. A perusal of Chapter XXVIII, 'On the Economic Position in France,' will indicate the reason quite clearly. The rise in the cost of living in France during the last year is traceable to the increase in the import duty, imposed, about a year ago, on wheat imports into France. In view of the heavy weight of taxation which prevails in this country, and the need for developing our export trades, we cannot afford to run any unnecessary risks in this matter. Before the stabilisation of wheat could have any practical value, it would have to, like gold, be the subject of an international agreement.

The oral evidence which I tendered to the Committee on Finance and Industry should be studied when it is published by the Committee. It will complete the history of the work.

The 'Dual System of Stabilisation' will, I think, be found to be the greatest measure yet devised for the advancement of the welfare of mankind. Its adoption would get rid of most of the social disorders and economic difficulties of the present time. The only serious objection likely to be raised against its adoption by certain bankers is that they have no desire to have their lending power controlled by the Central Bank, or that their margin of lending power should be made elastic and regulated in accordance with the country's needs. (See Chapter XV.)

Such defects as exist within the Federal Reserve System are solely due to the fact that the Federal Reserve Banks have no effective control over the system of

financial banking, which is controlled and developed by the member and non-member banks. The volume of lending power in the financial system should be definitely fixed at a ratio not exceeding nine to one, with full power to the Central Bank to lower it in case of an emergency. This would avoid the need for manipulating the re-discount rate, the raising of which is prejudicial to industry and trade. (See Chapters XIX and XX.)

This opposition of member banks to control by the Central Bank is brought out quite clearly, though not specifically stated, in the following quotation taken from an article written by M. H. de Kock in the *Economic Journal*, March 1931, on the South African Reserve Bank :

There are only three commercial banks of any significance in South Africa, two of which together control over 95 per cent. of the ordinary banking business, and these big banks are in themselves able, through their numerous branches, to level up matters to a large extent by meeting abnormal demands for loans in some parts of the country with the surplus funds in others. This factor in itself would tend to restrict considerably the field of operations for the Reserve Bank as a bankers' bank, in contrast to the conditions in Europe, and especially in the United States, where there are thousands of independent banks, but the position is rendered much worse *by the fact that comparatively little use has been made by these banks of the re-discounting facilities offered by the Reserve Bank, partly because they appear to be disinclined to borrow from the Reserve Bank to any extent and thus show reliance or dependence on it*, and partly as a result of there having generally been no great need of their doing so. *In other words, they have not yet come to adapt their method of working to the existence of a Reserve Bank in their midst, i.e.* working on a smaller margin of cash reserves and borrowing from the Reserve Bank for short periods at a time at the end of every month to meet the monthly pay-rolls and month-end settlements, and somewhat more at the end of every half-yearly period and in the Christmas or other busy seasons. At present they are indeed required by law to keep on deposit with the Reserve Bank such of their cash reserves as amount to 10 per cent. of their time liabilities, but they still carry

sufficient till money (notes, gold sovereigns and token coins) to meet the bulk of their seasonal needs, and consequently they do not have to borrow from the Reserve Bank at such times to any great extent. *It has also been said on some occasions that the banks could not risk reducing their cash reserves and depending on re-discounts with the Reserve Bank* when they had so little eligible commercial paper and Government securities in their possession, but with the extension of the eligible paper and securities under the Amendment Act of 1930 that argument is no longer valid.

The italics are mine.

As it has some bearing on the matter I would like to quote the following authoritative opinion taken from the Report of the Royal Commission on Indian Finance and Currency (paragraph 136), with which I concur:

Dealing with the question of the propriety of including Government of India securities among the reserves, it is easy to appreciate that they form a far less desirable asset than commercial bills, for they lack that most useful quality of the latter to expand and contract the currency automatically in accordance with the needs of the country. In the case of Government securities, expansion and contraction depends entirely upon the will and judgment of the currency authority, and is therefore more liable to errors of judgment.

Although the world is indebted to the American people for having adopted the Federal Reserve System, that system has still some way to go before it can be considered suitable for general adoption by all nations. But this much can be said. As and when Central Banking practice is perfected, and when the politicians and bankers of all nations appreciate more clearly the implications and reactions of the Quantity Theory of Money and the use of money, the world will then be able to get rid of most of the social and economic difficulties which afflict it at the present time. A modern Central Banking system is the greatest sociological measure yet devised for the advancement of the welfare

of any population. It is the only effective means by which an equitable distribution of wealth can be assured. A world-wide adoption of modern Central Banking practice would, in the shortest space of time, realise the most altruistic conceptions conceived by social reformers, and which, with the economic systems as they stand at present, must ever remain in the realm of dreams.

The most significant and illogical feature associated with the majority of currency systems in the world to-day is that an increase in the purchasing power value of each currency depends upon the limitation of its issue, and that a decrease in the purchasing power value is brought about by an increase of its issue. This is true in all cases where the currencies are covered mainly or wholly by securities. But I think I have clearly demonstrated in the pages which follow that an increase in the purchasing power value of a currency should not depend upon the limitation of its issue. A currency note should be the measure of value, and, as such, it should be invariable not only in itself but in its purpose. The one and only useful function which a currency note can perform is to be the yard-stick of value, and when it tends to interfere in any other way, it is an indication that its mechanism is out of gear, and that it should be corrected.

The increase in the purchasing power value of a currency should depend upon an increase of its quantity. This is the reverse of all orthodox teaching, and it may at first glance shock the purists ; but it is a sound doctrine nevertheless. It may be ' Peddism,' but social peace will only come to the world when it is widely accepted. Of this we can be certain, that it will transcend in power and influence all other schemes of social reform.

The fact that inflation and deflation, within a metallic monetary system, must necessarily retard the consumption and production of wealth, and that no cure

has hitherto been found for these defects, is a clear indication that the economists have developed a system of monetary science that has no relation to reality. It is this lack of contact between man and his actual environment that is the cause of all the social schemes for the state control of industry and finance. The solution of this problem is a pre-requisite condition of political and social harmony. It must necessarily be the starting point of any scheme of economic development and the basis of any new political alignment.

When society learns to draw a distinction between the proper uses of capital and of money, and to appreciate that wealth is not capital, harmony will prevail. The antagonism and suspicion manifested by working class movements towards organised society, arise from the knowledge that plenty exists, but that, for some reason for which the capitalist system is responsible, they cannot have access to it. They see no practical reason why they should not have a more equitable distribution of wealth, and there is none. Unsatisfied wants are really the cause of the present extensive social unrest. The tragedy of it all is that it is more economical to satisfy the unsatisfied wants than to leave them unsatisfied.

It is my earnest belief that the 'Dual System of Stabilisation' is the measure that will restore harmony between mankind and its environment. I pray that it may succeed in the purpose for which it has been designed.

J. TAYLOR PEDDIE.

LONDON, S.W. 1.
March 31, 1931.

PREFACE TO FIRST EDITION

As the originator of the 'Dual System of Stabilisation' I develop it still further in this work. It was outlined in my last book 'The Invariable Standard and Measure of Value.' Although the 'Dual System' may be regarded as being unorthodox, yet it can be said that established economic principles are not brought into question; on the contrary, it is emphasised that they are fundamentally true, but that they cannot become effective until they are employed under correct economic mechanism. Faulty mechanism frequently induces wrong economic conclusions. Furthermore, I demonstrate that if the industrial mechanism is sound, monetary policy can be made more elastic since it will operate on a sounder basis.

What is the 'Dual System'? It is a system which does not embody either free trade or protection. It is one which enables producers to assume control of the price level, to take it away from money, and to promote rising wages and falling prices. Its adoption is essential if import duties for revenue are not to resolve themselves into 'a system of protection,' which would undoubtedly increase costs of production and the cost of living generally. This would be a serious matter for the exporting industries that have to compete at the world price level.

Under the 'Dual System' the full claims of agriculture could be met without increasing the cost of living. In fact, speaking relatively, the cost of living could be reduced. This would eliminate the bogey of 'food taxes.'

Let me say, at the outset, that no part of the case which I am advancing is based on theory. It is based

on existing tendencies, or facts. An industrial economist, if he is to be of any service to the producers, must be able to observe and gather up the sound economic tendencies which exist, and develop them into an economic concept of a practical nature, discarding those that are unsound, and that may be retarding progress. I should not attempt to ask the producers to develop new theories that are based on mere assumptions. The producers to-day have no time to waste on theories. There are a sufficient number of practical tendencies in existence which experience has proved to be sound, and all that I have done is to gather them up into a new economic conception. Whether this work has been successful or not, I must leave to others to determine.

As indicated in the Conclusion of the book, a Central Reserve Bank should be the parent of a credit policy based on wealth production and not of a banking policy. But the basis of a sound banking policy should be the co-operation of the joint stock banks with the Central Reserve Bank so as to ensure the maintenance of sound banking principles.

In the search for an economic solution of the depression now prevailing in the basic industries, such remedies as European Free Trade, Empire Free Trade, Empire Preference Trade, Safeguarding, an International Central Bank, and the like, are suggested. Without entering into a discussion on the relative merits of these proposals, which can arise at a later time, I can say that they do not touch the fundamental issues we have to deal with. Our first concern is to find a national solution that will enable us—

(*a*) To create a Budget surplus within two years of at least £175,000,000 per annum, from which to begin effective reductions of the national

debt and taxation, without increasing the rate of taxation.

(*b*) To absorb the bulk of the unemployed into active productive industries within twelve months.

The attention of the country should be focused entirely on this issue, and it should not be allowed to be obscured, or diverted, by incidental issues, no matter how desirable they may appear to be on the surface. It may be taken for granted that the Dominions and Colonies are not prepared to assume any portion of the weight of taxation imposed in Great Britain. Therefore, the British people must first of all find their own national solution of this problem, before they can see how far they can enter into outside commitments.

The 'Dual System of Stabilisation' is an important economic evolution. Its implications have been widely accepted in industrial, agricultural and financial circles. Consequently, it should not be assumed that all converted free traders are prepared to accept import duties without qualification. In many cases the substantial safeguards duly indicated in the general theme of the book will be required.

My acknowledgments are due to The British Economic Federation, to the Members of its Executive Committee, and to its Members generally, for their kind and loyal assistance. Particular acknowledgments are due to Mr. Edmund William Janson for his work in founding the Federation with me in 1927, and for ensuring its continuation since in spite of great difficulties. For three years prior to 1927 I carried on active propaganda work alone.

The British Economic Federation has submitted two Economic Surveys to the Prime Ministers of the day, namely: to Mr. Stanley Baldwin, April 1928, and to Mr. Ramsay MacDonald, September 1929. A great

deal of credit must therefore be given to the Federation for bringing about the appointment of the Committee on Finance and Industry, and for the wider general knowledge on monetary science which now prevails.

My acknowledgments are also due to the Federation of Master Cotton Spinners' Associations. As its representative, I have submitted a Précis of Evidence to the Committee on Finance and Industry, and in view of the responsibility which the Federation has assumed by giving the plea for monetary reform the weight of its authority, all those for whom I speak desire to commend the Cotton Spinners for their public spirit and initiative.

Part I of the book is mainly concerned with destructive criticism, and Part II with constructive proposals.

J. TAYLOR PEDDIE.

LONDON, S.W. 1.
June 27, 1930.

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THE DUAL SYSTEM OF STABILISATION

PART I

CHAPTER I

THE RETURN TO THE GOLD STANDARD

Early in 1920 a policy of deflation was initiated by the Government. Credit was contracted, and at a later period the currency in circulation was diminished. The sharp drop in prices which commenced in the autumn of 1920 was not expected by the industrial community, who were not in any way taken into the confidence of the Government when its policy was considered. It was intended that deflation should be gradual. In fact, deflation was unduly rapid.

When deflation was decided upon by the Government and the Bank of England in March 1920, the first step to this end was to raise the Bank Rate to 7 per cent. Prevailing market discount rates were raised proportionately. It was estimated that this measure alone cost the Government and the traders of the country, in increased discount rates on Treasury bills and interest charges on bank overdrafts, etc., about £26,000,000 during that year. The rise in the Bank Rate also brought about a considerable fall in the market value of all classes of securities, and a considerable contraction of bank loans.

The question here to be decided is whether the raising of the discount rate to 7 per cent. was effective in bringing about deflation. In my view, the manipulation of the discount rate for this purpose is not fully effective, and it proved to be so in this case. The following short history of subsequent events confirms this view:

(1) The wholesale price level reached its highest point in April, May and June 1920, but the cost of living reached its highest point in November 1920.

(2) The sterling rate of exchange reached its lowest point in November 1920.

(3) And last, but not least, the circulation of the currency reached its highest point on December 29, 1920.[1]

The contraction of the currency, therefore, could only have taken place after the sterling exchange had reached its lowest point. In other words, the rise to parity was only made possible through the Budget surplus which was then—for the first time in post-War history—in process of being realised, and which enabled the Treasury to contract the currency substantially; this act alone paved the way for the return of the exchanges to parity, *i.e.* the theoretical gold standard.

The moral of the above is that it is impossible to control an abnormal credit situation by merely manipulating the re-discount rate. The only effective way of doing so is through policy and mechanism.

It has been stated by economists, and by late Chancellors of the Exchequer, that a falling price level, due to deflation, means an increase in purchasing power,

[1] At this date the currency in circulation was as follows:—Treasury notes, £364,924,000; certificates, £33,060,000; and Bank of England notes, £144,934,000, making a grand total of £542,918,000. To this should be added the silver and copper coins in circulation, the figures for which are not procurable. In the latest return made by the Bank of England (April 11, 1930) the total of the notes issued is given at £419,829,239.

but this presupposes that, in the meantime, there has been no diminution in the volume of currency in circulation and in the volume of credit available to industry and trade. As there had been a considerable contraction since 1920 in the volume of currency in circulation, free from the control of the banks, then obviously it cannot be said that purchasing power has increased with the falling price level. The truth of the proposition depends, for any particular class in the community, upon whether the distribution of currency and credit has remained the same.[1] In other words, whilst it is true to say that the purchasing power of the currency tokens has increased—due to their reduction in amount—it is not true to say that the purchasing power of all the consumers has increased.

The point is important, since there are many more people without bank accounts than there are who have. The term 'cheapness' is a relative one, and it can only be determined by the relation which may exist from time to time between the commodities available for purchase and the means of payment that exists within the working community.

From its lowest point of \$3.33½ in November 1920, the dollar exchange rate on London was raised to \$4.85 in April 1925, and in this month the Government returned to the theoretical gold standard. This rapid appreciation of sterling necessitated a corresponding deflation of internal prices, and produced important adverse effects upon various industries, notably on our exporting trades and agriculture.

If the unpegging of exchanges in March 1919[2] was an error of judgment, responsibility for the error should be laid at the door of the Government of the day and the

[1] I repeat this point on page 130 in order to emphasise its importance.

[2] The inflation that took place prior to March 1919 was a consequence of Government policy in relation to war finance and currency.

Bank of England, and not at the door of the producers. The producers had to carry on their business at the current exchange rates of the day. The joint stock banks were free lenders during this time, a fact which indicates

DEPOSIT RATE (BANKS)

—	1919.	1920.	1921.	1922.	1923.	1924.	1925.	1926.	1927.	1928.	1929.
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
First half	3 0 0	4 8 7	4 16 0	2 7 1	1 0 0	2 0 0	2 12 0	3 0 0	2 16 0	2 10 0	3 5 11
Second half	3 7 9	5 0 0	3 8 9	1 0 7	1 19 7	2 0 0	2 10 0	3 0 0	2 10 0	2 10 0	3 14 0
Whole year	3 3 10	4 14 4	4 2 4	1 13 10	1 9 9	2 0 0	2 11 0	3 0 0	2 13 0	2 10 0	3 10 0

SHORT LOANS (DISCOUNT MARKET)

—	1919.	1920.	1921.	1922.	1923.	1924.	1925.	1926.	1927.	1928.	1929.
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
First half	3 4 7	4 16 0	5 7 2	2 18 0	1 10 1	2 9 10	3 9 8	4 1 2	3 17 6	3 13 0	4 8 2
Second half	3 14 7	5 11 2	3 18 2	1 13 10	2 3 4	2 15 0	3 8 10	4 1 0	2 12 6	3 12 0	4 16 3
Whole year	3 9 7	5 3 7	4 12 8	2 5 11	1 16 8	2 12 5	3 9 3	4 1 1	3 15 0	3 12 6	4 12 3

that they, at all events, did not appreciate the full implications that arose from that error. If the Budget had been balanced at that time it would have enabled the exchanges to be stabilised. The considerable losses that were incurred during the fall of the sterling rate, and again

during its rise to parity, with its inevitable restriction of currency and credit, at a time when industry was endeavouring to adjust itself to peace instead of war conditions, were large contributing factors to the subsequent depression in the basic industries. Had the correct policy been pursued at the outset, a substantial portion of the subsequent losses in which the producers have been involved could have been avoided. When deflation was decided upon, the producers were left to get out of their difficulties as best they could, to assist in which they have been recommended to adopt rationalisation.

In the years 1922–3 discount rates in the money market were manipulated downwards in order to bring about a rise in the market value of Government Securities. The average rates for deposits and short loans are shown in the tables on opposite page.

This policy was successful, but when War Loan and the various issues of National War Bonds were raised to well over parity, it became necessary to devise means by which their market prices could be anchored at their increased values. The only way by which this could be attained was to return to the gold standard. Preparations were accordingly made for this, and the discount and short loan rates, and Bank Rate, were forced upwards by stages in order to bring sterling to parity, which was achieved in March–April 1925. The tables on p. 6 of average Bank Rates in London and New York are instructive.

The return to the gold standard was only made possible with the assistance and co-operation of Messrs. J. P. Morgan & Co., New York, and the Federal Reserve Board. The Governor of the Bank of England, Mr. Montague Norman, proceeded to New York and made the necessary arrangements. An agreement was concluded which provided for the creation of a $300,000,000 credit. I believe it was not found

necessary to use any portion of this credit, which was subsequently discharged.

BANK OF ENGLAND BANK RATE (DAILY AVERAGE)

—	1921.	1922.	1923.	1924.	1925.	1926.	1927.	1928.	1929.
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
First half	6 16 0	4 7 1	3 0 0	4 0 0	4 12 0	5 0 0	4 16 0	4 10 0	5 5 11
Second half	5 8 9	3 0 7	3 19 7	4 0 0	4 10 0	5 0 0	4 10 0	4 10 0	5 14 0
Whole year	6 2 4	3 13 10	3 9 9	4 0 0	4 11 0	5 0 0	4 13 0	4 10 0	5 10 0

FEDERAL RESERVE BOARD BANK RATE (DAILY AVERAGE)

—	1921.	1922.	1923.	1924.	1925.	1926.	1927.	1928.	1929.
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
First half	6 18 0	4 9 6	4 7 2	4 4 6	3 5 11	3 14 0	4 0 0	5 2 4	5 0 0
Second half	5 2 3	4 0 0	4 10 0	3 2 1	3 10 0	3 17 9	3 6 8	5 0 0	4 17 8
Whole year	6 0 3	4 4 9	4 8 7	3 13 3	3 7 11	3 16 3	3 16 8	5 1 2[1]	4 18 10[1]

According to a cablegram, however, which appeared in *The Times* at this period, it was stated that responsible

[1] During the period of high money rates in the U.S.A., the re-discount rate for eligible Bills of Exchange was not affected. This was a decided advantage to the producers of the U.S.A. as compared with this country. In other words, credits based on wealth products received preferential treatment over credits based on more speculative transactions.

banking opinion in New York asserted that ' in order to maintain sterling at parity, *England must be willing definitely to forgo her former pre-eminent position* as the market for long-term loans, *and willing also so to conduct the Bank of England's discount policy as to keep the London short-loan money market on a higher basis than New York.*'

The history of Bank of England policy since 1924–5 would seem to confirm the above, which, in my view, was an unnecessary sacrifice. It is a matter that requires the closest examination.

I wish to emphasise that the manipulation of the discount rates in the discount market, and of the Bank Rate, in recent years, has been disastrous from Great Britain's point of view. The only way by which Great Britain can be brought back to her former supremacy in the world's financial and trading markets is for her Central Bank to be given a new policy and mechanism. In the present-day world, and in view of the existence of the national debt, policy and mechanism are the only substitutes for the manipulation of Bank and Discount Rates, the expense of which alone has been for Great Britain exceedingly costly.

In recent weeks, and in consequence of the falling-off in world trade generally, a reversal of the policy of manipulating Bank Rates upwards has been entered upon. The Central Banks are now manipulating Bank Rates downwards, with a view to cheapening the price of money and stimulating trade.[1] But the lowering of Bank Rates, and the cheapening of the price of money, will not increase the volume of production or of money. Should any new money be made available it will first of all be employed in the stock exchanges and other speculative markets, causing a rise in the market value of securities and natural materials. This is the first process of an

[1] The policy of cheapening the price of money artificially has been extended since I wrote this in the first edition.

inflationary movement, and, in view of the existing world deflationary movement in commodity prices, caused by the shortage of gold for monetary purposes under existing policies, it will be concealed.

In any event, the lowering of the Bank Rate will not cheapen the price of credit for the productive industries in Great Britain in view of the declared policy of the joint stock banks to charge '½ to 1 per cent. over Bank Rate for overdrafts or loans, with a minimum of 5 per cent.' As I have indicated, any new money made available will be used, first, to expand speculative credits in the hope that, secondly, a reflex action of this will be to expand consumers' buying power, which will set up a demand for goods that do not exist, and thus check the fall in the wholesale price levels. I do not say that, at the present time, this is, or is not, desirable. But what I do say is that it is not the correct procedure, and, in the later chapters, I will show how this defect ought to be dealt with. If credit is to be expanded on a sound basis, so as to eliminate inflation and deflation, it must be expanded through producers first, and not through consumers.

CHAPTER II

WHAT IS THE GOLD STANDARD?

In the course of his speech at Brighton in the autumn of 1929, Mr. Snowden said: 'The country is on the gold standard. There were some of us who, at the time the change was made five years ago, doubted whether that step was not a little too precipitate; but it was taken, and since then practically every other country in the world has come upon the gold standard, and there is no one, not even the advocates of what was known a year or two back as managed currency, who does not admit that now that the gold standard has been universally re-established it must be maintained until the wisdom of man has devised some better substitute for it.' But I do not agree 'that practically every other country is on the gold standard.' I agree that many of them are on a gold exchange basis, but that is not a gold standard. The legal requirements of Central Banks in countries on a gold exchange basis usually are that they shall hold as cover at least 40 per cent. in gold and claims on foreign currency, against their currency note issues. The cover required for the remaining 60 per cent. is left to the discretion of the authorities controlling the Central Banks, but it is usually composed of securities. There are no legal requirements as to what the balance of the cover shall be, which is a weak point. The claims on foreign currency are usually made up of dollar and sterling securities, and bills of exchange on London which are convertible into gold if required. These countries, by

holding sterling securities and bills of exchange on London, not only earn interest on these securities, but, when they are realised, they are given a call on the gold reserves which already form part of the cover of the currency note issues of the Bank of England. Thus the British monetary system is always subject to unnecessary external disturbances, which prejudicially affect the industry and trade of the country.

Do upholders of the gold standard support present monetary policy because they believe our gold reserves to be (1) our standard of value, (2) our measure of value, or (3) because the holders of currency have the theoretical right of converting their notes into gold? At one time they had the actual right of converting into gold, but this right has now diminished to a theoretical one. As the financial editor of *The Times* said not long ago, in an indiscreet moment, 'the gold standard was a working myth, but it worked very well.' There should be no working myth about the gold standard if it is a sound one.

The Bank of England notes now in circulation are only covered by gold to the extent of about 37 per cent.,[1] so that they cannot now be held to represent the standard of value and be the measure of value. I can certainly agree with the financial editor of *The Times* when he characterised our so-called gold standard as 'a working myth.'

As we know, a pound note is only useful for what it will buy. If this be so, then surely it should be anchored to the mass of production, which is the true standard of value. The value of any commodity, other than works of antiquity, is what it costs to produce. Why, then, should the production of real values be limited to the credit that can be pyramided on the currency notes and minor coins held by the joint stock banks, particularly when 70 per cent. of the credit created by them originates

[1] Read notes to Chapter XIII at this stage.

in Government and other securities,[1] and when the currency notes issued by the Bank of England are only covered to the extent of about 37 per cent. in gold, the remaining 63 per cent. being in Government securities?

To be on a strict gold standard all currency notes issued should be covered to the extent of 100 per cent. in gold. If the full cover of 100 per cent. is departed from, strictly speaking, the currency is no longer on a gold standard, although the principle of convertibility may be readily maintained. The pyramiding of credit on currency notes not fully covered is inflation.

Most people support the gold standard because they desire to retain the right—mainly to establish confidence in our currency in foreign markets—of converting their currency into gold. This is the true and only purpose to which our gold reserves should be put. If limited to this, all that is required is that our currency should be on a pound standard, which in reality it is struggling to be at the moment. In a pound standard a 20*s.* note is all that is required. A 20*s.* note is the true measure of value, and the holders should have the right of converting it into anything they want, including gold.

The pound standard is based on credit that originates in production and terminates in consumption; the soundest form of currency and credit, since it is all fully covered. The bulk of the credit now created under the gold standard originates in Government debt, but it cannot be terminated in the debt. It is therefore the weakest form of credit, since it can only be terminated by a redemption of the debt.[2] But the burden of redeeming the debt must fall on the producers and traders of the country. This conclusively points to the fact

[1] This particular question is dealt with separately in Chapter IX.

[2] This same argument applies to all other credits that originate in home and foreign investments. In these cases credits can only be terminated by a sale or redemption of the securities.

that there must be a larger volume of credit originating in production and terminating in consumption, from the taxation of the profits of which only can the debt be redeemed. Hence we arrive at the pound standard.

As pound notes are only useful for what they will buy, it is not necessary to argue that the notes should be fully covered in gold. It would be as logical to argue that they should be fully covered by any one of the consumable commodities, such as butter, eggs, cheese, tea, copper and platinum, etc. There need only be a sufficient reserve of these to meet the needs of the public. Its needs in the immediate period of time only are all that a currency system has to concern itself with. Short-period transactions only can be covered by a currency system that presumes to give effect to a barter system of economy.

America is on a dollar standard, and it is one of the only two countries in the world that retain the right of free convertibility of their currency into gold coin. If a dollar standard is good enough for the United States, I submit that a pound standard is good enough for Great Britain. It will enable her to grapple with the high costs level imposed on her producers, and also enable her to retain her political and industrial independence free from international interference.

I have now said sufficient to indicate that the gold standard does not exist, and that, if it could exist, it is unnecessary. In the present-day requirements of the world it is not possible for any country to adopt a gold standard. No country could afford it, since it would necessitate the most drastic form of deflation, and the starving down of the respective populations to the quantity of gold money available. Therefore, when we enter into an argument over the gold standard, let us have clearly in our minds what it is we are arguing about.

I have been handed a copy of a summary of an address

on 'The Relation of Monetary Policy to Production,' given by Mr. R. G. Hawtrey, the well-known Treasury economist, to comment upon, and although I have not before me the full address he gave, it does at any rate summarise the views he has expressed in his well-known works. In the summary there are two monetary policies outlined, but Mr. Hawtrey does not show where the one ends and the other begins. But I do not believe there is any real difference of opinion between Mr. Hawtrey and myself, for I suspect that his views are more advanced than he is prepared to indicate. Because his summary accurately outlines the mechanism of existing monetary policy, I quote it in full, with comment:

Production is carried on with a view to exchange. When people work for money, their ultimate aim is to obtain the things that money will buy. Money is a mere token or medium.

Nevertheless the *immediate* motive of economic activity is money, and anything which affects the supply of money reacts upon economic activity.

The 'supply of money' for this purpose means the daily (or monthly or yearly) amount of money that is being spent by consumers on goods of all kinds—the 'consumers' outlay.' The consumers' outlay is what is spent out of the 'consumers' income.' It includes the outlay upon investments (*i.e.* savings) and accordingly it is true (except over short periods) that the consumers' income and outlay are equal.

In any industry the sum available to furnish the incomes of everyone concerned consists of the outlay on its product, the proceeds of sale. The whole of the proceeds of sale go to provide incomes—wages and salaries, interest, rent, profit. The prosperity of a particular industry depends upon the outlay on its product being maintained. If the outlay dwindles, *i.e.* demand falls off, there is less available for the incomes of those engaged in it. Profits are less, and employment is less, or profits and employment can only be maintained by a reduction of wages.

Adversity of that kind may occur without any monetary cause. There may be a transference of demand to other products.

But suppose that something occurs to diminish the consumers'

income *as a whole*. Consumers' outlay will also fall off, and *all* industries will find demand diminishing.

Similarly if consumers' income and outlay increase, all industries find demand increasing.

It is with such changes in the consumers' income and outlay that monetary policy is concerned. If we approach the subject from the standpoint of the stock of money, we employ the well-known 'Quantity Theory' of money. The consumers' income is proportional to the quantity of money in circulation, and to its 'velocity of circulation.' For this purpose 'money' must be taken to include substitutes for money, *i.e.* bank credit.

Up to this point, I largely agree with Mr. Hawtrey, but my agreement is contingent upon the basis upon which money (money = currency and credit) is created. Commodity money establishes a price-value, but metallic money establishes price and value. Under the former, the producers control the price level of commodities ; under the latter, it is metallic money. This aspect of the question I deal with fully in the later chapters, and when I speak of a metallic money medium, I speak of a currency and credit system, or systems, pyramided on, and limited by, a gold, gold exchange, gold and silver, or silver, basis.

I shall now deal with the second part of Mr. Hawtrey's summary in which we get the true implications of the gold standard (*i.e.* metallic money) as practised by the Bank of England.

But the quantity theory of money by itself tells us nothing of the causes which affect velocity, and little of those which affect the quantity of money.

In view of what I have said, it is easy enough to understand why the gold standard keeps us in ignorance on these points. It is because of the inability of the gold standard, as practised by the Bank of England, to express itself that we desire to see it altered to accord with modern central banking practice.

Under modern conditions bank credit is the most important part of money, and money both comes into being and is extinguished in the form of bank credit.

Banks determine the amount of credit they can create by reference to their cash reserves. But under the central bank system which exists in this and most other highly developed countries, the 'cash' of the joint stock banks is simply the obligations of the central bank, the Bank of England. By extending or restricting those obligations, the Bank of England can induce the joint stock banks in turn to extend or restrict credit. By their action the consumers' income and outlay are expanded or contracted, and producers find demand expanding or contracting.

The action of the Bank of England is governed by the gold standard. If the consumers' income and outlay are too great, there result excessive purchases of imports and an unfavourable exchange. Credit has to be restricted till these purchases are reduced to the equilibrium point. But that means a restriction of demand for products of all kinds, a falling price level, a general trade depression, and unemployment.

In these last three paragraphs we observe the fly in the ointment. It is to be noted that under existing practice the joint stock banks extend credit through consumers which ultimately finds its way to the producers. But 'the action of the Bank of England is governed by the gold standard,' and if the consumers' income and outlay are too great (which can only be the result of inflation due to the method of expanding credit) credit has to be restricted, which results in deflation. And then the producers are left to nurse the baby of inflation, and get rid of the goods they were induced to manufacture at the higher price level in consequence of the action of the banks in expanding credit in the way they do. Thus we see that in the creation of credit the joint stock banks are limited by their cash ratios, that the bulk of the credit they create is based on Government securities, and that their actions are governed by the manipulative policy of the Bank of England, which in turn is governed by the gold standard. Now we have the answer to the question: 'What is the gold standard?'

Mr. Hawtrey's concluding observations are as follows :

> The most important benefit that monetary policy can confer on production is the avoidance of contingencies of this kind. They arise for the most part (though not exclusively) from causes affecting the purchasing power of gold in world markets.
>
> That is a matter of international concern, and international action in some form is required. If value in terms of wealth can be stabilised, the need for expanding and contracting credit in any country to keep pace with its variations is eliminated.

I cannot agree with Mr. Hawtrey that the correction of British monetary policy is a matter of international concern and international action. As Mr. Hawtrey truly says at the beginning of his summary, 'Production is carried on with a view to exchange. When people work for money, their ultimate aim is to obtain the things that money will buy. Money is a mere token or medium.' And I will add, money is useful only for what it will buy. Thus if it is agreed that it should be anchored to the mass of British wealth products, and if it is agreed that the initial expansion of credit should take place through producers and not through consumers—in accordance with modern central banking practice—the desired alteration of British monetary policy must be a matter of purely national concern. A new monetary mechanism that will automatically remove inflation and deflation from the industrial system is all that is required.

CHAPTER III

DEFINITIONS OF THE VARIOUS FORMS OF CURRENCY

(*a*) A 'Gold Standard Currency' is one that is covered by an equivalent amount of gold bullion and/or coin held by the Central Bank in its own vaults, or mainly in its own vaults and partly elsewhere. No such currency exists in the world to-day.

(*b*) A 'Pound Standard Paper Currency' is one that is mainly covered by bills of exchange, the eligibility of which has been clearly defined by law, as in the case of the Federal Reserve System. The gold reserves held as cover against this form of currency can be held either in a fixed ratio of 40 per cent. gold to 60 per cent. bills, or, preferably, with an average minimum of 20 per cent. gold bullion held as cover, without any fixed ratio to the bills held as cover against the currency. 'The prestige of gold consists not in being the standard, but in being the best possible reserve for a Central Bank—the most saleable thing in the world with which to settle international balances of account.'

(*c*) A 'Convertible Fiduciary Paper Currency' is one that is partly covered by gold bullion and mainly by Government securities, the gold cover being held to guarantee convertibility of the currency. This system is the one now practised by the Bank of England, and is erroneously called a 'Gold Standard.' It is a 'Mythical Gold Standard.' Of necessity it must be limited in its scope and, when credit is expanded, inflationary in its tendency. But its inflationary tendency is anchored in

its dimension by reason of its adherence to the principle of convertibility, for which purpose it is expected to maintain a minimum of £150,000,000 gold cover against all issues of the currency. By law, however, the Bank of England is now obliged to cover all increases of its note issues by gold, but this provision merely limits still further the inflationary tendency of this form of currency.

(*d*) A 'Fiduciary Paper Currency' is one against which only Government Securities are held and which in practice is inconvertible. It may ultimately be redeemed out of Government revenue. This form of currency is highly inflationary in its tendency. In the United States, however, it is possible to convert at par the inconvertible portion of the currency of that country into gold, by exchanging it into a convertible currency. This is due to the strength of its financial position. In a country whose financial position is not strong, it is possible to effect sales of its inconvertible paper currency at a heavy discount in the foreign exchange markets, and in this way it can be converted into gold through the convertible currencies of other countries.

A Pound Standard Paper Currency is by far the best of the various forms of currency mentioned, since it is supported by self-liquidating bills of exchange drawn against the necessaries of life, such as wheat, fuel, cotton, wool, and finished and partly finished manufactures, all in course of production and distribution. Such a currency is said to be concerned with commercial transactions and not with financial ones. It effectively sustains what should be the first principle of the barter system, namely—that when we purchase a commodity or service, we sell in exchange a measure of value in other commodities, and that when we sell a commodity or service, we buy in exchange a measure of value in other commodities. In all cases, supply will precede demand—which is the correct principle—and not that demand

shall precede supply. Purchasing power will then reside in commodities and services, provided they are measurable in pounds, shillings and pence. The £ standard will resuscitate to the fullest extent the barter system of economy, and, as a result, it will in itself become the measure of value, *i.e.* the yard stick of value at 240 pence to the £. It will also neutralise the inflationary and deflationary tendencies of the Quantity Theory of money, whether due to an expansion or contraction of credit or an inflation of the currency without cover.

There is a superabundance of wealth in the world, but it cannot be fully distributed. Hence we have what is called over-production. It cannot be fully distributed because there is an insufficiency of wealth behind the currencies of the world. The consequential result is that the barter exchange of commodities and services for commodities and services cannot take place. The present world-wide so-called over-production really means that there is a world-wide insufficiency in the means of payment. Nothing more—nothing less.

Many national currencies have been de-valuated. No de-valuation of a currency could have taken place if it had been covered to the extent of 100 per cent. in wealth. But what is wealth ? Wealth is income. It is made up of the necessaries of life ; and the more of it we produce, the more of it we should be able to divide. Wealth is not capital ; when capital ceases to produce an income it ceases to have value. In this event, it becomes a liability. Therefore, the solvency of all Governments—and their debt holders—depends upon the volume and distribution of their national wealth, and the means of payment that exist for this purpose. In other words, solvency cannot be maintained by extending taxation ; it can only be maintained by extending production and the power of the consumers to consume.

CHAPTER IV

PRESENT METHOD EMPLOYED IN EXPANDING CREDIT

I SHOULD now like to direct attention to the method employed in expanding credit when the means are available. The only way by which credit may be expanded on a sound basis within the existing system is by a gold import. When the credit is available, the first channels through which it can be let out are : (1) the money market ; (2) the Stock Exchange, and (3) the metal and produce markets. If there is a likelihood of continued easy money conditions, speculation sets under way in anticipation of an industrial revival. Prices of natural materials soar, and when the industrialists are prepared to use them, they have to pay enhanced prices. This method of expanding credit has no doubt led many economists to assert that prosperity in industry was only possible in a period of rising prices. This assertion is undoubtedly true in the existing mechanism. But it is based on a defect in the mechanism. It is certainly not one that the producers desire to support or approve of. Established economic principles are fundamentally true, but their efficacy and efficiency entirely depend on the mechanism under which they are employed.

As credit expands under present mechanism, prices rise. An expansion of credit increases demand. An expansion of demand presupposes an increase of production. An increase of production presupposes a decrease in the cost per unit of goods produced. Puzzle :

Why should prices rise, since the natural tendency is for costs and prices to fall, and wages to rise? Because the defect which exists in the method of expanding credit gives to money an arbitrary control over the general level of prices; it begets inflation, and subsequently deflation, which, if sounder mechanism were employed, could be avoided. Sound mechanism would automatically give to the producers the control of the general level of prices, which would be determined by the volume, and cost, of production. In other words, money should no longer have any control over the general level of prices.

Some bankers assert that present monetary policy is the best in the world, and cannot be improved upon; and that no sound industrial proposition is ever refused credit facilities. This argument is specious and deceptive. The number of sound industrial propositions in England to-day is extremely small. The point that is generally overlooked is that the banks are working to definite fixed ratios, *i.e.* 11 per cent. cash in relation to deposits, and 55 per cent. advances in relation to deposits. Now it is well known that deposits cannot be increased until there has been an increase of cash, *i.e.* legal tender money, and that this is not possible on a sound basis without an import of gold. We know that the Bank of England can increase the cash held by the joint stock banks by purchasing securities in the open market, but this is a form of inflation, and is therefore a departure from gold standard principles. Such an operation—under existing mechanism—impairs the quality of the basis of credit, and is therefore undesirable. An extension of credit upon such a basis should not be permitted. In my opinion those who profess an adherence to sound gold standard principles should be the first to practise what they preach. A further answer to the statement that the joint stock banks do not

refuse credit on sound industrial propositions is to be found in the following quotation taken from the book entitled 'Post-War Banking Policy,' pp. 81–2, by the Right Hon. Reginald McKenna, which I cordially support :

> We can take an illustration from current events. Large orders have been given recently by the railway companies with the express intention of finding more employment. The firms which have taken these orders will require more credit from the banks for the purpose of paying wages and buying raw materials. If the banks are to give this credit and at the same time maintain their recognised cash standard, one of two things must happen ; either their cash resources must be enlarged, or they must restrict their grants of credit in other directions. But if other borrowers for industrial purposes have their credits cut down, their capacity to trade will be reduced, and we shall lose in unemployment in their trades what we gain in employment on the railway orders. If there is to be an increase in the total employment the banks must obtain additional cash resources, and this can only be effected by the Bank of England letting out more money.

There will thus be two monetary systems open to us to consider, namely, (1) a national system, in accordance with modern Central Banking practice, designed to promote and intensify production within the home market ; and (2) the maintenance of a monetary system somewhat akin to the present one, which is designed to promote a system of international trade in marginal differences, *i.e.* a trade of buying in the cheapest market and selling in the dearest, and which gives to holders of Government and other securities a preferential pull on the available credit resources. From the evidence which follows, it will be shown that we cannot divide until we create, and that the more we create, the more we can divide. This business of creating wealth, and dividing it, is a matter which concerns our own national productive power ; and it is obviously impossible that a banking mechanism which rests solely upon inter-

national trade, Government Securities, and foreign investments can provide the requisite facilities to permit of an intensification of national production. I am naturally in favour of a national system of production and distribution, and—in view of the high costs level prevailing in this country, brought about by the weight of taxation—I am opposed to the maintenance of the sheltered industry of free imports.

Although I am in favour of the development of an exclusive national monetary policy for Great Britain, I am also in favour of the development of modern Central Banks for all nations, so as to effect internationally an economy in the use of gold. It is clear that no country in the world could afford to adopt an exclusive gold standard, which implies that every currency note issued should be covered to the extent of 100 per cent. in gold. I believe there are only two countries in the world where the right of convertibility into gold coin is maintained, namely, the U.S.A. and South Africa, the only two countries to possess modern central reserve systems, yet they are not considered to be on a gold standard. But these two countries could very well afford to dispense with the luxury of a gold coinage in order to economise the use of gold, and with a view to advancing the general prosperity of world trade.

The privilege of being able to convert currency into gold bullion or coin on demand should not be reserved exclusively for the first-class Powers. Modern central banking practice insists upon a ratio of 40 per cent. gold cover to 60 per cent. of fine commercial bills. If every nation is to be given the advantage of the so-called gold standard, as practised by the Bank of England, there would clearly not be a sufficiency of gold to go round. Even with the ratio system as practised by Central Reserve Banks, there would be an insufficiency of gold for monetary purposes. But if the mechanism

which I advocate, and which for convenience I have described as the 'Dual System of Stabilisation,'[1] were to be adopted universally, then it would enable each nation to adopt modern Central Banking practice without the need of a fixed ratio of 40 per cent. gold to 60 per cent. bills. All that would be necessary would be for each nation to hold a fixed maximum limit of gold reserves, without any fixed ratio. In the case of Great Britain, for instance, £175,000,000 is all that would be necessary for this purpose. The U.S.A. could work with considerably less than it does at the present moment, and likewise France. This is the most effective way by which nations may economise in the use of gold. In any event, a much lower ratio of 40 per cent. in gold could be considered.

There could be no greater work undertaken by the League of Nations than the development of Central Reserve Banks in all countries. Such an undertaking would, of course, raise the question in an acute form of the economical distribution of the world's supplies of gold for monetary purposes. A primary condition would have to be that the League did not interfere with the national independence of any country. It should seek to confine the powers of the International Bank of Settlements to the settlement of reparation questions only. The International Bank might commendably undertake the functions of an international clearing house for the settlement of foreign exchange transactions, differences being settled weekly, fortnightly, or monthly, as may be desired. Each Central Bank might reasonably be expected to hold a small amount of its gold reserves with the International Bank for this purpose. The greatest care would have to be exercised, however, in preventing the International Bank from acquiring an arbitrary power over the distribution of the world's gold supplies. It should not even be permitted

[1] The 'Dual System' is defined in Chapter XVIII.

to buy gold for its own account. If it were allowed to do so, it would soon supersede the Parliaments of the World and the League of Nations.

If the right of convertibility of currency notes into gold is the only sound basis of a monetary policy, then it should obviously be the duty of the League of Nations to introduce the system into all nations. In this age of enlightenment, the benefit of the system should not be withheld from any nation because of the fear that it might increase the scramble for gold. The mere fear of 'a scramble' should of itself condemn present international monetary practice. Because of unsound monetary conditions in India and China, the Lancashire cotton industry is losing its trade in those countries. The fall in the value of silver has impoverished the people of those countries to a great extent, although their potential productive power remains the same. But in the absence of an adequate supply of gold for monetary purposes, China has been confined to the use of silver as her legal tender medium, with results that are only too well known. I trace all the political disturbances in the world to an economic cause, namely, that the people in the disturbed areas are not able to distinguish between the proper uses of capital and money. Owing to the restrictive influences, and injustices, imposed by the latter, the whole capitalist system is condemned. Bolshevism is an extreme doctrine, but it is fighting with an instinct that in some degree it is right. If the monetary machine can be adjusted to a scientific basis, Bolshevism and all other '-isms' will soon disappear. Mankind is seeking for a better distribution of wealth.

CHAPTER V

EFFECT OF AN INCREASE IN BANK RATE

An increase of 1 per cent. in the Bank Rate—if maintained for one year in order to attract foreign short balances and thus enable the Bank of England to protect and increase its gold reserves—costs alone, in financing bank bills, commercial bills, bank advances, Treasury bills, and foreign balances, a sum of £25,000,000. If all other forms of debt be added, it would reach a further considerable sum. This expenditure is incurred in order that the Bank of England may increase its gold reserves by £20,000,000—a sum sufficient to justify a reduction in the Bank Rate in the absence of stable exchange rates. We have to pay for the gold we buy, but we pay in charges alone more than the gold is worth. It certainly cannot be considered sound finance. Moreover, the total expense of the high Bank Rate should be placed against the commissions of £65,000,000 which the financial market claims to earn from foreign transactions.[1] The free gold market would then appear to be an expensive luxury when visualised in this way.

It may be said, of course, that the interest charges on most part of all fixed debts are fixed until their date of maturity, but if the Bank Rate be raised it must bring about a fall in the market value of all securities. Holders, therefore, lose a substantial portion of their capital

[1] A monetary system based on modern central reserve banking practice would not diminish these earnings.

through depreciation, the effect of which is the same as if they had to pay the increase in the Bank Rate.

Furthermore, the high interest yields which British securities thus offer, open the door to the investment of foreign capital in the country and foreign balances in the money market, which, whilst of temporary advantage, is of no permanent advantage, so long as the present economic system is maintained.

In view of the existence of the high costs level in Great Britain, it is a great mistake to assume that a high Bank Rate will influence shipments of gold to London, beyond the regular shipments that find their way here, or other shipments sent to protect foreign currencies. When the Bank Rate is raised by the Bank of England, other Central Banks follow suit, so that its intended effect is neutralised, and all that happens is that we have a period of high money rates. In any event, the time would seem to have arrived when a rise in the Bank Rate should cease to affect the price of internal credit extended to the producers of this country. The lowest possible discount rate should be given to commercial credits, *i.e.* bills covered by wealth products and eligible for re-discount at the Bank of England.

The external movements of gold should cease to affect the internal level of prices. An attractive economic mechanism, within which capital could find safe and remunerative employment at home, and internal production and exports could be increased, is the only sound alternative that exists for adjusting an adverse financial position such as Great Britain is faced with to-day.

The object in asking for a differential re-discount rate in favour of commercial credits is to increase what List describes as the country's 'power of disposition.' When the Bank of England raises its rate with a view to curtailing credit and attracting gold to London, if no

differential rate exists in favour of the productive and exporting industries of the country, particularly if there are frequent upward changes in the rate, the competitive power of the exporting industries is curtailed. Thus the full credits which these industries could create abroad are not available to assist in preventing a drain on the Bank of England's gold reserves. The country's "Power of Disposition," *i.e.* the power of the exporting industries to sell, and create credits abroad, should be an essential part of Central Banking mechanism. If the raising of the Bank Rate prevents the exporting trades, even in the slightest degree, from continuing their beneficial work, then it must defeat part of the Bank's objective policy.

Another point to which consideration should be given is whether the drain on the gold reserves in 1929 was wholly due to speculation in New York. Although this speculation was brought to a dramatic end, the gold that found its way there from London has not yet wholly returned. Apart from the holding of large foreign balances in the money market, which are always subject to withdrawal if discount rates are higher elsewhere, the true explanation may be that, in consequence of the high money rates prevailing in New York in 1929, New York bankers were drawing on London acceptance houses for temporary accommodation, *i.e.* taking advantage of the cheaper money rates then prevailing in London as compared with New York. I have good reason for believing that this was a substantial contributing factor, and that it was the curtailment of these facilities, aided perhaps by the rise in the Bank Rate to 6½ per cent., that influenced the sudden collapse on the New York Stock Exchange. If it be so, then we should ascertain whether the Bank of England did not in fact give re-discount facilities to such bills, and thus aggravated the drain on the gold reserves.

It should be a strict rule in financial circles that financial accommodation bills should be subject to the closest scrutiny, and that as a general practice they should not be accepted as collateral for loans in the money market, nor should they be eligible for re-discount at the Bank of England. This rule accords with modern Central Banking practice.

CHAPTER VI

EFFECT OF A DECREASE IN BANK RATE

After a period of high money rates, the effect of a decrease in Bank Rate is to increase the capital values of all classes of interest-bearing securities, particularly those issued during the period of high money rates. This will necessitate an increasing use of credit in order to finance the increased values. Furthermore, if money rates are to be cheapened for any length of time, it will make a free gift to all holders of Government Securities. Those securities issued at a discount will soon rise to parity. Those issued at parity, with a higher rate of interest, will soon rise to a substantial premium. Such tendencies impair the effect of the sinking fund since they will add several hundred millions to the market value of Government Securities. The basic industries are of the decided opinion that all Government Securities should be redeemable at the price of issue, and that, in any event, they should not be issued at a discount. The lack of a uniform policy in the issue of Government Securities is not understood.

The productive industries derive no advantage—in so far as it may affect costs of production—from the manipulation of the Bank Rate downwards, and the cheapening of money rates, nor from the increase in the market value of Government and other securities. When the Bank Rate is manipulated upwards above $4\frac{1}{2}$–5 per cent., the trading community has to pay a proportionate increase in the rate charged for bank loans. But when the rate

is lowered below 4½–5 per cent. the producers derive no advantage, but their competitors do, *i.e.* those engaged in the sheltered industry of free imports. The latter are able to discount their bills in the money market, and thus enjoy the benefit to be derived from the cheaper money rates. They are not obliged to use bank overdrafts, whereas the producers are confined to the use of these alone.

It is generally understood that the joint stock banks have introduced a rule for the future guidance of their business, to the effect that, on all overdrafts or advances, customers will be expected to pay ½ per cent. to 1 per cent. over ruling Bank Rate, with a minimum of 5 per cent. From this the basic industries infer that, if the ruling Bank Rate should happen to be 2½ per cent., the joint stock banks will in any event charge 5 per cent. It is to be hoped that the Committee on Finance and Industry will consider this point, and determine whether this fixed rule is to affect any new re-discount facilities which it may recommend a remodelled Bank of England to concede. In order that prosperity may be restored to the country, it is essential that the basic industries should have full and direct access to the Bank of England for re-discount facilities, and that the rate of discount should be determined by the ruling Bank of England re-discount rate only, and not by any fixed arbitrary minimum rate determined by the joint stock banks.

The joint stock banks may contend, of course, that the expense of maintaining their head offices and numerous branches necessitates a minimum rate of 5 per cent. But if this be so, then it is essential that they should adopt the advice they have so frequently tendered to the basic industries in the past, namely, rationalise their industry. The fundamental need of the country to-day is an adequate supply of cheap money, particularly for

productive purposes, and if it is essential for the joint stock banks to do twice the business for the same profit they are earning to-day, then their directors should not hesitate to face this issue. They have had a long period of earning easy profits at the expense of industry—their reserves should by now be very strong—so that they can now well afford to pursue a more patriotic policy without any possible risk of loss.

Certain bankers assert that the minimum overdraft rate of 5 per cent. is justified because, at the present time, they have to pay 3¾ per cent. for time deposits. Even if this point was material, it is an open admission that, in order to maintain their lending capacity, they have to rely, in part, upon borrowed money in the shape of time deposits. In Chapter II, I have shown that the joint stock banks extend credit mainly on the obligations of the Bank of England, which is controlled by the gold standard, which in turn is controlled by the short foreign balances in the money market. The gold standard, as practised by the Bank of England, would seem to be a business which relies upon borrowing other people's money, and lending it out at a profit ; and the joint stock banks extend the business.

The economic system should be mainly concerned with approximating production and consumption, and it would be absurd to contend that the development of production, which alone creates cheap and sound money, should depend upon the facility with which the money market and the joint stock banks can borrow money in the shape of call or time deposits. Just as wages should be paid out of the product on which labour may be employed, so should currency be created on the products which labour may produce in order to ensure the payment of the wages, and an equitable distribution of the wealth that may be produced.

A re-discount rate of 1 per cent. would provide an

ample margin to cover the cost of this service by the Central Bank—the Bank of England. The acceptance houses to-day are more than pleased to accept sound business at a commission of 1 per cent., and at this figure they make handsome profits. As the money created is new money, and is not borrowed, we can observe how an extension of production alone will create cheap and sound money. The joint stock banks do provide additional services which will certainly necessitate an additional charge, but such services are not worth more than an additional ½ to 1 per cent. in the case of commercial bills, which should cover the endorsement of the bills when re-discounted by them at the Bank of England.

Economic science should be mainly concerned with the production and consumption of wealth, which should be an organised business. The business of borrowing and lending money may be said to be an organised business, but it is not a wealth-producing business. Yet it has become the master of production, and not the servant. To-day the total value of all things produced is determined by money; and the price money can afford to pay is determined by its quantity.[1] Hence, 'price' and 'value' are maintained as two separate factors. The maintenance of employment, and the determination of 'price,' have to depend upon the ability of the joint stock banks to satisfy the demand for monetary accommodation for productive purposes. If

[1] This can be explained more clearly by the following simple illustration: Assume that the total trade of the country was equal to one million tons of coal, and that the quantity of money available was equal to one million £'s, then the price of coal would be equal to £1 per ton. Now let us assume that in the following year we increased the output of coal to two million tons, and that the quantity of money remained the same, then the price of coal would only be worth 10*s*. per ton, since there would be two tons of coal for each £1 available. If we desire to maintain the price of coal at £1 we must increase the quantity of money proportionately to the output. This outline is to be taken merely as an illustration.

this be limited it is easy to see how such a system can be exploited and manipulated.

It is to be hoped that the Committee on Finance and Industry will also determine whether, in the event of the bank rate falling to 2½ per cent., foreign importers of goods should be allowed to enjoy the facilities of the London money market, when these are prohibited to British manufacturers. In this case, after allowing for the payment of the acceptance commission of 1 per cent., foreign importers of goods and merchant traders in the world markets would be obtaining credit at 3½ per cent. in the London money market, whereas British manufacturers would have to pay the minimum overdraft rate of 5 per cent., thus suffering a handicap of 1½ per cent. The full discount facilities accorded to foreign importers and merchant traders in the London money market should be extended to British manufacturers. The latter should not be handicapped by being confined to the use of the overdraft at their bankers. This may necessitate a drastic overhaul of money market practice, and the introduction of modern Central Banking practice, but the Committee should not hesitate to face this task if it proves to be necessary.

CHAPTER VII

THE PRICE OF MONEY

(Money = Credit and Currency)

The greater the volume of money that originates in production and terminates in consumption, the cheaper will be the price of money, since it will cheapen proportionately with the increase in the volume of production.

If the bulk of the credit created on an exclusive gold basis originates in Government debt and other securities, the dearer will be the price of money, since, if trade is inclined to become active, the competition by producers for what remains must be keen. Ultimately, however, such a position must weaken the productive and competitive power of the nation. As this will result in a diminution of production and consumption, the price of credit may cheapen, but, if it does, it will be due to a lack of demand for credit, and not because of any increase of efficiency in creating credit that originates in production and terminates in consumption, which alone promotes the creation and distribution of wealth. It is the increase of bank deposits brought about by the increase and distribution of wealth that ultimately, and permanently, cheapens the price of money.

A pound note is useful only for what it will buy. Thus, the currency that is based upon bills of exchange which are backed by wealth products is the soundest of all forms of currency. Even assuming a sufficiency of

gold could be obtained for monetary purposes in Great Britain, it would not be as effective as the bill of exchange in expanding currency upon a sound basis, *i.e.* in eliminating inflation and deflation. There is really no sound alternative to bills of exchange based on wealth products.

Therefore, as an expansion of currency takes place on proper cover, the price of money will cheapen, like any other commodity, by reason of the increase in its quantity. We shall not only obtain a falling costs level, and a gradually falling price level, but also a falling off in the price charged for money for productive purposes. The suggested re-discount rate for eligible commercial bills to be maintained by the Bank of England should be on the lowest possible basis, which, in turn, should considerably assist the Government in refunding its long term debt and in discharging its short term indebtedness.

An orgy of speculation may, of course, set up a demand for credit for speculative purposes, and thereby increase the price of money for general purposes, which increase may ultimately have a reflex and disturbing effect on the re-discount rate for eligible commercial bills, and on the lower rate at which the Government should be able to borrow. But so long as the whole of the credit position is controllable by the Central Bank, it will always have the power to regulate any defect of this kind. The present method of regulating speculation by a raising or lowering of bank and discount rates, and/or by a general expansion or contraction of credit, should, in future, be prevented, since it imposes an injustice on all those producers who conduct their business in a legitimate manner, many of whom are ignorant of monetary technique ; and, because of this, fall into business difficulties which they are not able to estimate.

CHAPTER VIII

THE THREE DIVISIONS IN THE ECONOMIC SYSTEM

EINSTEIN was recently asked if he could give a simple definition of Relativity, and he defined it as follows : 'Relativity, as I see it, merely denotes that certain physical and mechanical facts which have been regarded as positive and permanent are relative with regard to certain other facts in the sphere of physics and mechanics.' I proved this theory some years ago in my own line of investigation. As in physics and mechanics, so it is in economics. But in physics and mechanics, natural laws are permitted to operate freely and naturally in an ordered system, whereas the three divisions in economics—which are presumed to constitute the economic system—are not only individualistic but perverse.

We think we live and work in a complete defined economic system, but we do not. I will endeavour to show that there are three distinct divisions in our so-called economic system, namely, (1) Production ; (2) Government Finance and Taxation ; (3) the Monetary System ; and that the last two are parasitical since they can exist only by feeding on production. It cannot be said that any one division is relative to the others.

I will take Government finance and taxation first. In consequence of the War, the total of our nominal national debt has grown to £7,500,000,000, the interest charges on which alone amount to £315,000,000, and I have already shown that, in consequence of our monetary

system being based on an exclusive gold basis system, about 70 per cent. of our credit resources are employed in financing the internal portion of the debt and foreign investments to the exclusion of production. I may be asked how this statement can be proved. In the Economic Survey sent to the Prime Minister last September, by the British Economic Federation, it was pointed out that 'as the total of British Government, Foreign Government, Railway and Industrial Securities is very much higher than it was before the War, it follows that the percentage of bank advances must be extremely high, probably in the vicinity of 70 per cent.'; also, 'that Mr. W. W. Paine in his evidence before the Colwyn Committee conjectured that about £1,000,000,000 out of a £3,000,000,000 levy would represent capital which might be used from time to time for credit facilities.' It is impossible to obtain definite proof. All we can do from such evidence as is available is to arrive at a broad assumption by an inductive process of reasoning. It is one of those points which representatives from the basic industries might have been allowed to inquire into, since it entails information which they have been unable to procure.

But I will now endeavour to carry the argument a stage further in the search for conclusive evidence. In consequence of the defects in our monetary policy, and in consequence of the depression now prevailing in the basic industries, each successive Government has been obliged to incur capital expenditure in order to relieve the poverty, distress and unemployment created thereby; but the total poverty, distress, and unemployment cannot actually be relieved in this way. There are politicians who seem to think that all you have to do in order to extend relief is to create doles and pensions, and incur capital expenditure on the building of roads and public works. These gentlemen seem to be unable to

recognise the simple truth that when a Government spends money, it is, in effect, creating a debt and not a credit. No matter whether a Government indulges in capital expenditure or gives guarantees to capital issues, and/or the interest charges thereon, it does not, and cannot, whilst present monetary policy is maintained, create credit and employment thereby. All it does is to create a liability which must be redeemed at some future date by the productive industries of the country. It is but natural that our legislators should do what they can to extend relief, for no man or woman really likes to see the dreadful poverty and distress which now surround us, without making some effort to relieve them.

But why have we been driven into creating debts and not credit? Because our bankers and economists believe that if they allowed an expansion of currency to take place based on wealth production, it would, in effect, be an inflation of currency. But, as I have shown, no inflation of currency can take place if all expansions of currency are properly covered by self-liquidating assets, and if the mechanism employed is sound. Inflation can only take place if issues of currency are based on Government securities, which are not proper cover, or if they are based mainly on Government securities and partly on gold, as they are at the present time. In either of these cases there is a vacuum which should be filled in, and if it is not, inflation must take place. It makes no difference whether the Government's IOU forms the basis of currency, or whether its securities are being financed through bank credit, since, in both cases, they form part of the credit structure.

I should like to make this point of filling in the vacuum quite clear. Inflation can be caused by using Government securities, wholly or mainly, as the basis of currency, but it can also be caused by using them extensively as

security for bank credit. Strictly speaking, inflation means that the available quantity of money has been largely used for purposes other than production. In the past, inflation has simply been regarded as a rise of commodity prices, which involved an increasing use of bank credit to finance the increasing cost of a given volume of commodities. But it can also be regarded as inflation if there has been an undue proportion of bank credit used to finance Government and other securities, and particularly if the credit is to be used for the payment of taxation.

Another form of inflation is that caused by the more economical use of gold as a basis of currency by the Bank of England, and by the falling ratios of cash to deposits held by the joint stock banks. What happens here is that the volume of credit is being pyramided at the expense of its quality. I certainly believe in the principle of a more economical use of gold as cover for the currency, but to the extent to which we depart from full cover in gold, to that extent should we substitute bills of exchange backed by wealth products. This is what I mean by filling in the vacuum. With this revised mechanism we could derive all the advantages of deflation and inflation without their disadvantages. This will be achieved by insisting that all currency note issues are covered to the extent of 100 per cent. by wealth products—including the gold reserves—and that, where it is impossible at present, they should be gradually restored to this basis.

Our present gold standard system is the greatest inflationary system that ever existed, and, from some points of view, it is the greatest sham and imposture ever perpetrated on an innocent public. It is the defects of the system that has originated the attacks upon capitalism. And when we talk of the merits of currency systems, it should be borne in mind that they cannot be divorced from Government debts. If I may modify Einstein's phraseology to suit my argument, the physical and

mechanical facts on which a currency system is based are relative to the physical and mechanical facts on which the national system of finance is based. If these are soundly related the whole economic system will be sound, since it will work cohesively. If they are unsoundly related, incohesion will result. In other words, we must combine the total of our national debt, and the weight of taxation, with the total of our quantity of money ; and this combination will determine whether the whole financial system is not inflated out of all proportion to our restricted wealth productive power. Government debt and the quantity of money are all convertible into gold, yet the actual real wealth behind these at the present time is negligible.

The important point which I wish to emphasise is that the financial system must include national debt, national taxation and the monetary system ; and that when these are combined, it will become apparent whether or not the total has been inflated out of all relation to the wealth into which it is presumed to be convertible. If the financial system is visualised in this way, the extent of the inflation will become apparent, and from the producers' point of view it will also become apparent that the inflation should be deflated as rapidly as possible. I do not suggest that this should be done through repudiation of debt, but through a rapid extension of wealth production done within the country, so that the cost per unit of goods produced may be reduced, and it is only from the taxation of the profits which can be earned in this way that it is possible for the producers to redeem the country's liabilities without inconvenience.

Those who designed the present currency system were extremely clever. They brought about an arrangement whereby all Government debt and expenditure were separated from the monetary system, so as to ensure that currency and credit would always be, as they thought at

the time, convertible into gold, and although it is still a working myth, it works very well. Orthodox economists and bankers have no objection to inflation provided it is largely transferred and confined to our Government debt. In this way it becomes a profitable transaction to finance Government securities through bank credit, and the recent issue of the 5 per cent. Conversion Loan is a glaring example. There was even no objection to the taking of an extra ½ per cent. commission for those subscribing to the loan. If a Government indulges in excessive borrowing in order to overcome the handicap of an exclusive gold basis system, the price of money must increase, hence the reason why bankers as a rule do not object to this form of inflation. They would probably object to it if it were overdone, but we are not far from that position now.

In order to prove the inter-connection between Government finance and taxation and the monetary system, it is only necessary to say that the holders of Government Securities and of Treasury Bills have the right, and claim it, of converting their securities into gold on demand. This is done by a sale of the securities in the open market for currency, which in turn is convertible into gold bullion. Treasury Bills do in fact constitute the largest part of the trade in bills in the money market. This right of converting the internal Government debt, bank credit, and currency notes—the total of which amounts to about £8,750,000,000—into gold bullion, with the total reserves standing at £151,000,000 only, without taking into consideration the needs of industry and trade, imposes a strain which introduces elements of risk that are disadvantageous to the producers. This right of convertibility also stabilises the market price of Government Securities, subject to there being no variation in the rate of interest. From the figures I have quoted, it will thus be clear that the financial system is inflated

beyond redemption in relation to the quantity of gold.

Nothing can redeem the position but a rapid reduction of debt and taxation, which can only be brought about, as I have stated, by an immediate and considerable expansion of production done within the country, to enable which an improved monetary policy, designed to suit national needs, as distinct from international, is required.

As I have more than once stated, it is only by an extension of production that we can permanently create cheap sound money. An extension of debts based on an exclusive gold basis system creates dear money. I assert positively that a falling costs level, a falling price level, and cheap sound money can only be brought about by an increase of production; also that the real cure for poverty, distress and unemployment can only be found in this way. We cannot divide the good things of this life until we produce them, and the more we produce, the more we can give in charity. In the U.S.A., about £350,000,000 per annum is distributed by rich people to Universities and in charitable endowments, whereas in this country it requires the creation of Government debt to achieve a similar purpose. If a Government creates debt for purposes of this kind, it merely redistributes the poverty and distress thus relieved to other shoulders, the majority of whom cannot afford it, and who bear it in silence.

I am confident I express the sentiments of most people when I say that we do not object to deserving widows and aged people receiving benefits so long as we can afford them. But what I wish to emphasise is that, when a Government imposes taxation in order to provide pensions, it does not create money; on the contrary, it gives the recipient a call on the wealth products of the country. But if the producers are restricted in their production by the operations of the whole

financial system, then they cannot afford to distribute charity from their limited resources in this forced way. Furthermore, it is more than probable that if the producers were able to produce to the maximum of their potential productive power, many of those now in need of charity could have their wants satisfied through employment ; and I venture to suggest that they would prefer this course.

I have now referred to the three divisions in the economic system, and what they mean. If the basic industries are to recover their prosperity in the only way possible, the time has now come for them to insist upon the subordination of Government finance, and the monetary system, to the needs of productive industry, so that a rapid process of deflation in Government debt, the interest charges thereon, and taxation may be brought about.

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CHAPTER IX

ON GOVERNMENT SECURITIES AS THE BASIS OF CREDIT

FROM the point of view of industry I do not agree with the following conclusions of the Colwyn Committee Report, pp. 334–5, for reasons which I state later. I have inserted the important points in *italics*, which, although the committee regarded them as 'questions of little importance,' are precisely those which the productive industries object to most :

981. A further aspect of debt redemption which has been mentioned in evidence before us *is the effect of repayment upon the volume of credit available to trade and other borrowers.* The position as we see it is that the Government through taxation acquire command of a certain proportion of purchasing power and transfer this to a former debt holder. If the holder is an individual, little effect need be anticipated. *He may, of course, use it to repay a bank advance ; in that case the credit is available for another borrower,* and no reduction need take place unless general conditions are such as would in any event lead to a reduction in the demand for credit. *The position of borrowers in regard to the deposit of Government securities as collateral has been discussed* in connection with the Capital Levy (para. 778 *et seq.*) ; obviously, *it is a question of little importance in connection with more gradual repayment of debt.*

982. The effects of repayment of the debt holdings of banks, while more complicated, are not necessarily different in the result. *The combined operation of taxation and repayment improves the banks' ratio of cash to deposits.* The ability of the bank to lend is thereby improved in precisely the same way as it would be if the bank were to sell in the market, *but the observance of conventional proportions between the various assets of the bank will probably*

restore the status quo. Temporary movements may obscure the position; as Mr. McKenna observed, the first outlet sought by the banks may be to lend to the money market and other borrowers in the habit of borrowing from the Bank of England, and thus to lead to the repayment of loans to that bank and a reduction of the cash balances of the banks generally. (Q. 1941.) But, broadly, it appears to us that, while the occasion of debt repayment would be a convenient opportunity to effect a reduction of the credit basis, if on general grounds that were deemed desirable, there is nothing inherent in repayment which would lead to any restrictions.

983. One qualification has to be made on this point. Mr. Beaumont Pease indicated that, if a part of the resources of banks is held in the form of Treasury Bills, *the banks are able to lend more readily than when resources are locked up in less easily realisable long-term investments.* (E. in C., 6.) *The same point was referred to by the Federation of British Industries.* (E. in C., 40.) *The repayment of bills and short-term loans may, therefore, lead to the adoption of a somewhat higher ratio of cash to deposits and thus tend to some restriction in advances to borrowers.*

984. With debt repayment upon any scale which is within the *capacity of annual taxation, we think the effects upon the demand for credit and the ability to provide it need be of little importance.* The whole matter is referable in the long run to the general policy which is being pursued *in regard to the regulation of credit through adjustments of the bank rate and otherwise.*

It may be said that Government Securities or any other securities—where the capital is already spent—cannot extend the basis of credit unless they are themselves used as the basis of the quantity of money. On the other hand, if they were used exclusively as the basis of the quantity of money, rapid inflation would ensue.

It may be true to say that the existence of Government Securities increases the demand for credit, and that they provide the banks with an unimpeachable security, against which the industries cannot compete, so long as Government credit remains good, and the volume of credit is anchored to a convertible currency. The provision of Government Securities, as collateral, does

certainly enable the banks to work on a lower cash ratio, and thus assists them in providing more credit for lending against similar securities. To this extent only do they extend the basis of credit. But do the banks really extend credit by lending against Government Securities? Is sound credit not that which originates in production and terminates in consumption? If this be so, how can Government Securities extend the basis of credit? I can quite see that, if Government Securities were paid off to any considerable extent, the banks would have to reduce their lending capacity, and work with higher cash ratios, and that this would be 'of little importance to industry.' I do not disagree with this conclusion, but it begs the question.

If credit originates in Government Securities, and if the basis of that credit be a convertible currency, *i.e.* bank cash, then it is clear that, under present monetary policy, gold only can extend the basis of credit, and not Government Securities. But if the basis of the quantity of money be theoretically gold, *i.e.* if the currency is not fully covered by gold, or gold and wealth products, then the technical difficulties become more acute, since there can be no standard of value, no measure of value, and no convertibility of the currency except on the limited basis now permitted.

The credit which originates in Government debt cannot be terminated in the debt.[1] It can only be terminated by a redemption of the debt, and this duty is one that falls exclusively on the industry and trade of the country, and the facility with which they can pursue this task depends upon their degree of prosperity. Thus it follows that a larger volume of credit should be made to originate in production and terminate in

[1] It may be argued, of course, that the securities can be sold, but this would simply mean that a transfer of the credit has taken place. For a further development of the argument see p. 167.

consumption, since this form of credit only can with certainty increase employment, effective purchasing power, and prosperity. Likewise this form of credit only can increase the competitive power of the basic industries abroad. From this proposition it follows that the only instrument that can effectively extend the basis of credit, and maintain gold as an international means of payment, is the bill of exchange backed by self-liquidating wealth products.

In 1914 the national internal debt was £670,000,000, mostly in Consols at 2½ per cent. In 1928 it was £6,500,000,000, the average rate of interest on which is 4⅝ per cent. Of this amount, according to Mr. Walter Layton's estimate in the Colwyn Committee's Report, £1,650,000,000 was held by foreigners, trusts, charities, trade unions, and joint stock companies. The proportion held by the joint stock companies cannot be ascertained, but such companies as do hold them are mainly concerned with the financial, chemical, tobacco, oil, and luxury trades. The companies associated with the basic industries can only hold a very small proportion of the total, and of these only the largest and most prosperous may be considered to be the holders. Broadly speaking, it may be stated that the basic industries, including agriculture, are not the owners of Government Securities.

On December 31, 1913, the total of the advances made by the joint stock banks was £603,000,000. On December 31, 1928, it was £1,196,000,000. If we assume, merely for the purpose of comparison, that 10 per cent. of Government Securities are required to be financed by the banks at any one time, it follows that in 1914 the proportion of bank advances required to finance Government Securities was £67,400,000, and in 1928, £650,000,000. In other words, in post-War years Government Securities absorb a much greater proportion of the lending capacity of the banks than they

did before the War. This argument is not affected by the percentage figure used.

That the foregoing assumption is based on solid ground may be gathered from the statement made by Mr. W. W. Paine, who, in his evidence before the Colwyn Committee, conjectured that about £1,000,000,000 out of £3,000,000,000 levy would represent capital which might be used from time to time for credit facilities. And it may be inferred from the following sentences extracted from the above quotations taken from the Colwyn Committee Report :

A further aspect of debt redemption which has been mentioned in evidence before us is the effect of repayment upon the volume of credit available to trade and other borrowers.

The position, as we see it, is that the Government through taxation acquire command of a certain proportion of purchasing power and transfer this to a former debt holder.

If the holder is an individual, little effect need be anticipated. He may, of course, use it to repay a bank advance ; in that case the credit is available for another borrower, and no reduction need take place unless general conditions are such as would in any event lead to a reduction in the demand for credit.

The position of borrowers in regard to the deposit of Government securities as collateral has been discussed in connection with the Capital Levy ; obviously, it is a question of little importance in connection with more gradual repayment of debt.

One qualification has to be made on this point. Mr. Beaumont Pease indicated that, if a part of the resources of banks is held in the form of Treasury Bills, the banks are able to lend more readily than when resources are locked up in less easily realisable long-term investments. The same point was referred to by the Federation of British Industries.

The repayment of bills and short-term loans may, therefore, lead to the adoption of a somewhat higher ratio of cash to deposits and thus tend to some restriction in advances to borrowers.

With debt repayment upon any scale which is within the capacity of annual taxation, we think the effects upon the demand for credit and the ability to provide it need be of little importance.

The whole matter is referable in the long run to the general policy which is being pursued in regard to the regulation of credit through adjustments of the bank rate and otherwise.

As the total British Government, Foreign Government, Railway and Industrial Securities is, therefore, very much larger than it was before the War, it follows that the percentage of bank advances employed in financing such securities must be extremely high, probably in the vicinity of 70 per cent. Hence it follows that the large volume of borrowing on securities of all kinds has restricted the proportion of credit available to the producers compared with the proportion available in pre-War years. This reveals a very serious position for a country whose prosperity is dependent on its ability to produce and compete at the world price level.[1] It is here that the quantity theory of money begins to operate, which theory rules that if the volume of production remains the same, and the quantity of money available for production is diminished, then prices and wages must fall, which is precisely what is happening to-day. But it should be noted that the price of money does not fall, and that the falling price level is forced in a limited production by a limitation of credit, which must involve all producers and workmen in losses.

If it be true to say that taxation is largely shifted to costs of production, and, as a consequence, British producers are suffering from a high costs level, which no conceivable increase of industrial efficiency could wholly overcome, how is it possible for any producer in the basic industries, who may be fortunate enough to be able to obtain credit on Government Securities, to employ such credit profitably in production? If Great Britain is a better market to sell in than to buy in, is it the contention that the possessors of Government Securities are running unnecessary risks in using them for an extension of credit for industrial purposes, and that the banks are aiding and abetting?

[1] This points to the necessity of separating commercial banking from financial banking; see p. 186.

It would seem to be desirable that a full statement should be submitted by all the joint stock banks showing the quality and character of the collateral which is held by them against their advances. The fact that the joint stock banks are working on a cash ratio to-day of about 10·8 per cent., when, before the War, a safe ratio was considered to be 15 per cent.,[1] indicates that they are not afraid of any substantial depreciation in the quality of the securities they are at present holding against the bulk of their advances. In view of the fall in the general level of prices throughout the world, and their general tendency to fall still further, I should be surprised if the joint stock banks were running unnecessary risks in this direction.

As Government debt does not extend the basis of credit—as it is in fact an incubus—it should be discharged at the earliest possible moment. This task can only be achieved if the volume of credit which originates in production and terminates in consumption is extended. Likewise, the interest charges payable on the debt should be reduced to the lowest possible level. But this also cannot be achieved until the volume of credit that originates in production and terminates in consumption is extended, which alone creates cheap money.

[1] The ratio of cash to deposits of ten of the London Clearing Banks, according to statements issued towards the end of each month, was as follows during the early part of 1914:—Jan. 16·2, Feb. 15·4, March 15, April 15·3, May 15·2, June 15·7, July 15·3.

At December 31, 1913, the ratio of cash to advances was 33·6. At April 30, 1930, the corresponding ratio was 19·4.

Notes to Chapter IX

If the proposed changes in monetary policy are given effect to, and if thereby the re-discount rate on eligible bills of exchange is considerably lowered, it would seem to be essential that the whole question of the interest rates payable on existing Government securities should be brought under review, and, if possible, modified, for otherwise a considerable and fortuitous premium would accrue to the holders of the securities at the expense of the industry and trade of the country. It would certainly be wise to avoid any unnecessary increase in the market value of the National Debt, which is not an asset but a liability.

The whole National Debt should be placed on the basis of $2\frac{3}{4}$ per cent. tax free, and the securities should be issued at par with redemption periods of 10, 15, and 25 years. The scheme should be voluntary, and, if the whole of the economic policy were agreed to, there would be a ready response from investors to convert their existing securities. If the country's welfare is at stake the holders of Government securities will respond to any patriotic appeal, as they did during the War. In any event, if the whole economic policy were accepted, and in view of the lower re-discount rate foreshadowed, a substantial appreciation in the capital value of all marketable securities would occur, so that investors, by changing to the new form of securities suggested, would lose nothing; on the contrary, their capital would not only remain intact, but they would gain, more than proportionately, from the reduction of taxation and the prosperity that would ensue. In the event of some investors proving unpatriotic, it is suggested that future reductions of taxation should not apply to interest payable on Government securities. An attempt should also be made to modify the terms of the American Debt.

CHAPTER X

FOREIGN INVESTMENTS, FOREIGN IMPORTS, AND THE BASIS OF CREDIT

In a very instructive study of British foreign investments by Sir Robert Kindersley, published in the *Economic Journal*, March 1929, some very interesting and valuable information is obtained which bears on the present discussion. In a previous study of this matter by Sir George Paish, the latter estimated that in 1907–8 the volume of British capital invested abroad amounted to £2,693,000,000, producing an income of £139,791,000 per annum. In a later estimate for 1911, Sir George Paish stated that the corresponding figures were £3,500,000,000 and £190,000,000. That Sir George Paish's estimate was fairly accurate may be gathered from the fact that, during the War, when British investments in American Railway Stocks and Bonds were requisitioned for war purposes, the amount so collected was £623,000,000, which compares with an estimate made by Sir George Paish of £600,000,000.

Sir Robert Kindersley has carried the work a stage further, and he estimates that the amount of British capital invested abroad in 1927 was £3,990,088,000, being an increase of £490,000,000, and that the income receivable therefrom was £299,161,000, being an increase of £159,370,000 over the income receivable in 1907–8, and an increase of £109,161,000 over that receivable for 1911. The higher income receivable in

1927 is no doubt mainly due to the high interest rates prevailing at all financial centres as compared with 1911.

The following quotations are taken from a special article dealing with the Balance of Trade figures which appeared in the *Board of Trade Journal*, January 15, 1920:

> The excess of imports, the 'adverse balance of trade,' was clearly being met somehow. The question was how. We had evidently a great fund of invisible exports, *which enabled us to buy goods from abroad without exporting actual goods in exchange.*
>
> We had great sums, thousands of millions, invested abroad—in colonial and foreign loans, railways, industrial concerns, and so on. The annual interest payable to us *gave us a further purchasing power.*
>
> Not only were we able to meet the apparent excess in our purchases over our sales, but we were able to save money and steadily to increase our investments abroad. Our invisible exports, our invisible purchasing power abroad, continually increased during the ten years or so immediately before the War.

The *italics* are mine.

The first interesting point which arises out of the foregoing, and which bears on the present discussion, is that Sir Robert Kindersley's estimate of the volume of our foreign investments is confined to securities listed on the London Stock Exchange. As the total of this capital amounts to £3,990,088,000, and as the total of the British internal debt is £6,500,000,000, we arrive at a total of £10,499,088,000, which, in part, has to be financed by bank credit. So that my assumption that at least 70 per cent. of the credit created to-day originates in Government and other securities may be accepted as being fairly reasonable.

The second point is, that as we increase our investments abroad we increase the call upon bank credit, which, being limited to a theoretical gold basis, must

gradually restrict the amount of credit available to British producers. This results in a restriction of internal production and of the export trade; and, to make assurance doubly certain, the producers have to contend with the increase of imports which is necessary in order to discharge the interest receivable by British holders of foreign investments. Such income can only be received in the form of imports, in view of the existence of our Free Trade market, and the shortage of gold for monetary purposes. And if German reparations are to be classified with foreign investments, we have to accept imports from Germany in discharge thereof, whether we are the actual recipients of the reparations or not. As we are the largest available free market, we have to absorb a large amount of Germany's reparation payments due to other countries, such as France and the U.S.A., for whom we obligingly find gold in exchange therefor. We even have to find gold for Germany herself.

In connection with the foregoing, the balances of merchandise trade in recent years as between France, Belgium, Germany, and Great Britain should be studied at this stage (see p. 56).

The figures clearly indicate the reason why France, Belgium, and Germany, at the present time, have a command over gold in the London market.

It is well known that after the Franco-German War Germany encountered an acute period of trade depression due to the excess of imports she had to accept from France in satisfaction of the indemnity imposed on the latter. I have seen it quoted somewhere that this led Bismarck to remark jocularly that the next time he entered upon a war with France, he would make her win the war. Our position in relation to the Continent would seem to be similar at the present time.

In the table of figures which appears on p. 164 it will be seen that the increase in the percentage of the

excess of imports in relation to British exports, and the decrease in the percentage of the excess of exports of British manufacture in relation to retained imports of

Great Britain and	Imports *from*	Exports *to*	Excess of *Exports*	Excess of *Imports*
France	£	£	£	£
1921 . .	53,013,656	44,259,945	—	8,753,711
1922 . .	48,537,887	48,538,111	224	—
1923 . .	58,462,433	49,258,145	—	9,204,288
1924 . .	66,578,211	41,714,860	—	24,863,351
1925 . .	65,042,372	31,026,406	—	34,015,966
1926 . .	59,176,536	20,384,170	—	38,792,366
1927 . .	65,846,898	24,889,586	—	40,957,312
1928 . .	67,232,000	32,065,000	—	35,167,000
1929 . .	63,441,000	38,711,000	—	24,730,000
Germany				
1921 . .	20,513,801	17,861,350	—	2,652,451
1922 . .	26,523,377	32,110,750	5,587,373	—
1923 . .	39,994,041	42,624,167	2,630,126	—
1924 . .	36,888,265	42,586,928	5,698,663	—
1925 . .	48,403,494	44,226,072	—	4,177,422
1926 . .	72,609,965	26,351,802	—	46,258,163
1927 . .	62,066,798	44,035,421	—	18,031,377
1928 . .	63,726,000	40,947,000	—	22,779,000
1929 . .	68,790,000	37,120,000	—	31,670,000
Belgium				
1921 . .	32,861,836	19,629,388	—	13,232,448
1922 . .	23,618,752	25,031,582	1,412,830	—
1923 . .	27,476,497	25,234,088	—	2,242,409
1924 . .	36,386,576	22,667,817	—	13,718,759
1925 . .	35,556,819	18,667,080	—	16,889,739
1926 . .	44,853,301	14,266,224	—	30,587,077
1927 . .	47,617,057	17,373,073	—	30,243,984
1928 . .	43,876,000	17,595,000	—	26,281,000
1929 . .	44,289,000	20,187,000	—	24,102,000

foreign manufacture, somewhat coincide with the increase in the balance of trade figures, which include the interest receivable from foreign investments and the increase in the reparation payments made by Germany. The

figures can afford no satisfaction to any economist, whether he be orthodox or otherwise.

It may be that the considerable increase which has taken place in our foreign investments has been due to the weight of taxation prevailing in this country, and the consequential lack of suitable investments. In the last two years this has certainly been the prevailing feeling. But the rapidity with which foreign investments, internal indebtedness, and taxation have increased in recent years—the operation of the sinking fund has had very little effect in reducing the total of the nominal national debt—combined with Germany's reparation payments, presents a very real danger which must now be faced. In lesser degree the remark applies to the world generally, with the exception of the U.S.A. and France where the correct economic policies are being pursued.

Indebtedness, taxation, and free imports are now much too ponderous for the limited internal production which the monetary system of Great Britain permits. The increase of foreign investments [1] and taxation should be brought to an end, and an increase of internal production and purchasing power substituted therefor. If I may cite the case of Australia, it would be unnecessary for her to borrow so heavily abroad, nor would she be in her present monetary difficulties, if she were able to sell her exportable surplus of produce at economic prices. But the buying power of Great Britain is curtailed, and this applies to the world generally. At the present time, Australia finds it necessary to borrow more from her creditors, or, alternatively, to export her gold reserves, in order to cover her annual interest charges payable abroad, and her adverse balance of trade. In addition to which, she now finds it essential to impose high

[1] We could allow foreign investments to continue in cases where the proceeds were to be used exclusively in the purchase of British manufactures.

tariffs in order to shut off the excess of imports. At the present time, this is undoubtedly a wise measure, but as Australia has also decided upon the formation of a Central Reserve Bank to accord with modern central banking practice, she will soon be able to overcome many of the economic difficulties with which she is now confronted.

If Great Britain is to benefit from her foreign investments, the interest receivable therefrom in the form of imports must not be allowed to restrict internal production. It would, indeed, be a paradox if the past excesses of exports of manufactures, which formerly built up the foreign investments, were now to destroy the productive power which created the exports. It is like hamstringing oneself. I am not here arguing against the principle of foreign investments. How to guard ourselves against the present adverse effects of these, I indicate in Chapter XXII. What I seek to demonstrate is, that whilst our present monetary system is maintained, not only does the increase of our foreign investments—which must include the transfer of funds to the New York Stock Exchange—cause an increase in the excess of imports over exports, and a corresponding decrease in internal production, but it also necessitates an increasing use of bank credit to finance the securities. This gradually restricts the credit facilities available to British producers, and shortens the purchasing power of British consumers.

If Government Securities and foreign investments are not to prove to be a handicap to British producers, and if foreign investments are to be of value to the country, the producers must have the same access to credit as if the securities did not exist. Consumers' buying power must be increased so that countries like Australia may be able to export their produce, not only to pay the annual interest charges on their debts, but also to buy

those manufactures which they cannot produce themselves. This aspect of the question develops as the argument proceeds. Monetary systems must not destroy the underlying principles of a barter economy, or the ability of a nation to discharge its debt obligations. Owing to the defects in the systems, no such thing as a barter economy exists in the world to-day. International trade has now been reduced to a system of trading for marginal differences in gold. It is now a case of beggar my neighbour.

The moral of the foregoing argument is, that we must find a more attractive and secure market for the investment of British capital at home, for which purpose a new economic system is essential, so as to induce a substantial portion of the capital now invested abroad to return home. This is one of the effective ways by which we may hope to diminish the excess of imports over exports, and enable our exports to be increased. Far too much of the internal business we do is being produced abroad, and, as will be seen from the figures on p. 164, our relative percentage of actual production grows less and less as the years pass by.

NOTES TO CHAPTER X

The following are the Balance of Trade figures as published in the *Board of Trade Journal*, March 8, 1920:

BALANCES OF INCOME AND EXPENDITURE IN THE TRANSACTIONS (OTHER THAN THE LENDING AND REPAYMENT OF CAPITAL) BETWEEN THE UNITED KINGDOM AND ALL OTHER COUNTRIES.

Particulars	1927	1928	1929
	In Million £'s.		
Excess of imports of merchandise and bullion	390	358	366
Estimated excess of Government receipts from overseas [1]	1	15	22
Estimated net National Shipping income [2]	140	130	130
Estimated net income from overseas investments	285	285	285
Estimated net receipts from short interest and commissions	63	65	65
Estimated net receipts from other sources	15	15	15
Total	504	510	517
Estimated total credit balance on items specified above	114	152	151

The excess of imports of merchandise for 1929 was really £382,000,000, the difference being due to an excess export of gold for the year of £16,000,000. It should be noted that the figures, except the first item, are estimated, and do not include any record of capital transactions.

[1] Including some items on loan accounts.
[2] Including disbursements by foreign ships in British ports.

CHAPTER XI

THE WEIGHT OF TAXATION

BEFORE a true estimate can be formed as to the plight of the basic industries, and as to the need for a change in the economic mechanism, involving monetary policy, it is necessary to examine the conclusion of the Colwyn Committee, that the weight of taxation was not shifted to prices. I do not accept the implication of this conclusion, but before proceeding to state my reasons, it will be necessary to submit the following figures for consideration :

Sources of direct and indirect taxation on industry, which increase costs of production and impair the purchasing power of wages and income :

1928–9	£
Stamps (exclusive of fee, etc., stamps)	30,133,507
Stamps (postage), Telephones, Telegrams — Post Office profit [1]	9,200,000
Motor vehicle, etc., duties	25,534,701
Petrol tax (4*d.* per gallon)	16,200,000
Unemployment insurance (includes private employers)	16,500,000
Health insurance (employers)	28,000,000
Municipal rates	180,000,000
Food, drink and tobacco	211,300,000
Income tax	237,274,365
Super-tax	56,214,167
Death duties	81,020,758
	£891,377,498

[1] The net profit of the Post Office for the year 1929–30 was £9,200,000. This excess of profit is a direct form of taxation. In the U.S.A. the Post Office is purposely run at a loss.

The following figures show the weight of national taxation per head of population. They exclude the Post Office profit shown in the foregoing figures, but include customs and excise :

	1913–1914			1929		
	£	s.	d.	£	s.	d.
Great Britain	3	12	2	15	2	0
France	3	5	6	7	14	3
Germany	1	15	5	5	18	6
United States of America (Federal)	1	10	4	5	14	0
Norway	1	15	6	5	16	3
Denmark	2	0	2	5	9	6
Sweden	1	13	4	4	6	10
Czechoslovakia		—		3	16	2
Italy	1	11	10	3	10	11
Belgium	1	7	8	2	11	11
Poland		—		2	1	0

The above figures per head of population refer only to national taxation. The more important matter is, of course, the total of local and national taxation, since the proportion of the total which is borne by local taxes varies very much according to the constitution of the country. I have obtained such figures for a few of the more important countries, which are as follows :

	£	s.	d.
1. Great Britain	19	4	0
2. France	9	4	0
3. Germany	8	6	0
4. Italy	5	15	11

The above figures are not as up to date as those given for central taxation. Both sets of figures should be accepted as rough approximations only. But they can be safely used for any argument which deals relatively with the burden of taxation in this and other countries.

It can safely be said that all indirect taxation, other than those import duties which are neutral in character,

is wholly shifted to costs of production. Direct taxation is largely shifted to costs; and it has also a general blanket effect, which I refer to separately in the next chapter.

We tax the working-man's beer about 3*d.* per pint, which yields £75,000,000 per annum; we tax his tobacco 6*d.* per ounce; even matches are taxed, likewise sugar, and petrol 4*d.* per gallon, etc., etc.

From the items under the heading of food, drink and tobacco, alone, the Government derive a revenue of £211,000,000. Our expenditure on telephones, telegrams and stamps is inevitable, but the excessive charges that are made for these services increase costs of production and distribution.

The Colwyn Report on National Debt and Taxation, paragraph 636, states that 'the tobacco duty is a considerable tax on the average or normal consumer of small means. . . . The duty borne by the normal consumer with an income from £150 to £200 ranges perhaps between £3 10*s.* and £5.'

In paragraph 649 it states that 'the duty a working-man's family may pay where the income is about £150 per annum is about £7 to £8; and where the income is £200, this duty per family would be rather more.'

The Report also suggests that, even at their present reduced level, these duties 'must exercise some adverse effect on the standard of living of the poor, although, on the whole, that standard may be slightly better than in the years 1913 and 1914.'

With regard to the working population generally, the Committee were of the opinion that the duties on food, etc., were recovered by wage-earners from their employers, since wages were for all practical purposes regulated by the Ministry of Labour Cost of Living Index.

The items included in the Ministry of Labour Cost of Living Index Number are as follows :

Food.—Beef, mutton, bacon, fish, flour, bread, potatoes, tea, sugar, milk, butter, margarine, cheese, eggs.

Rent.—Rents, inclusive of local rates, of unfurnished dwelling-houses of the type usually occupied by working-class families.

Clothing.—Retail prices of men's suits and overcoats (ready-made and bespoke) woollen and cotton materials for women's outer garments and woollen and cotton underclothing and hosiery and boots. The prices relate to grades usually purchased by working-class families.

Fuel and Light.—Coal, gas, oil, candles, matches.

Other Items.—Soap and soda, domestic ironmongery, brushware and pottery, tobacco and cigarettes, fares, newspapers.

There are a number of items in the above list, such as coal, gas, rents, local rates, sugar, tobacco, matches and fares, which are subject to direct taxation, or to adjustment of price in themselves due to wage regulations and taxation. All such variations in price are therefore reflected in costs of production.

The following further comment from the Colwyn Report is instructive (paragraphs 608, 609 and 610) :

Further, even where the advance in the 1926 wage-rate over that of 1914 happens to have corresponded very closely with the rise of the index figure, it is not possible to say exactly or with certainty how much of the advance may be attributed to the extra burden of customs and excise duties. It is necessary to pay regard to two factors :

(1) The motive force leading to increase of the wage-rate ;
(2) The measure supplied by the index figure.

(1) So far as the cost of living is concerned, the *general* cost is the motive ; it cannot be said that so much of the increased wage-rate was sought and obtained on account of the price of sugar, clothing, or any other single item in the index ; nor can it

be said how much influence the price of beer, or of any other item not in the index, may have had.

(2) At the same time, the duties on tea, sugar and tobacco are represented in the index, and the index has, in the event, closely determined the increase given on account of the general cost of living.

It appears, therefore, that so far as the index has come into play, the duties on tea, sugar and tobacco have had a special influence on the wage-rate; the duties on beer, etc., have had a more remote influence.

The position is more clear when the various contributing forces have once settled a basic wage-rate and agreed to the application of the index to future variations in the cost of living. Any future increase of the tea and sugar duties, provided it affects the price of tea and sugar sufficiently, will then automatically be met by a corresponding, though not necessarily equivalent, advance of wage-rates. Incidentally, the advance may at the same time increase the purchasing power over beer, entertainments, etc.

Again, if the duties on tea and sugar were abolished and their prices fell, there would be a corresponding, though not necessarily equivalent, decrease in wage-rates; this also would affect the purchasing power over items not in the index.

Paragraph 701. *Conclusion on the General Burden of Taxation.* —Our analysis of the taxation required for the debt and for other expenditure leads to broad conclusions which will have become evident. The burden of indirect taxation appears formidable when viewed as a whole. On analysis, however, it is found that the duties on food are now light except for the sugar duty, which we consider relatively high. The high level of the duties on luxuries (as we understand the term) appears to us to be justifiable at present, considering the large amount of revenue required, and the risk of interfering too much with savings, if heavier direct taxation were adopted.

Paragraph 702.—The burden of direct taxation, while we do not wish to belittle it, is less crushing than is frequently represented. It does not, with trivial exceptions, enter directly into prices, and its indirect effects are not such as substantially to affect the general price-level. It has a materially adverse effect on savings, but this does not hold good, so far as the receipts are applied to payments on account of the internal debt. Again, it has widely diffused psychological effects, and has been responsible for a good deal of discouragement, while trade has been suffering

from long-drawn-out depression due to wider causes; on the other hand, some of the psychological effects have been actually beneficial. In our opinion the present taxation—even in conjunction with the loss of material wealth due to war expenditure, which lies behind the National Debt—is not one of the main causes of industrial difficulty. Causes other than taxation lie outside our province, but in their very wide range have been under the consideration of the Committee on Industry and Trade. For analysis of the serious difficulties of our export trade due to one set of causes—conditions prevailing in the various markets abroad—we may refer to the committee's introduction to their 'Survey of Overseas Markets (1925).' The overseas conditions dealt with cover the decline of purchasing power, the shortage of capital, the growth of local manufacture, etc. So far as taxation is concerned, we think that, if general conditions improve and times become more prosperous, the burden will be carried with comparative ease. We base our conclusions, not on preconceptions, but on the long analysis contained in the foregoing part of our Report, in the light of which they must stand examination. We may perhaps remark that the view which we take is more optimistic than the view which attributes to taxation a very large responsibility for the present industrial position; for, while there is little prospect of any great lightening of the tax burden in the early future, there is legitimate hope that in many respects more general conditions, both at home and abroad, may improve.

Notwithstanding what seems to constitute strong evidence to the contrary, the Colwyn Committee, in their concluding remarks, suggest that the weight of taxation is not passed on into prices. This suggestion may be true in the case of our basic industries where they must compete with foreigners at the world price level, not only in foreign markets but in the home market as well. Price tends towards lowest cost, and if we permit foreigners to compete in our home market with goods which do not have to carry the same proportion of taxation as our own goods, then obviously the weight of taxation cannot be recovered in our prices although it is included in our costs.

It may be true to say that the weight of taxation is

not shifted to prices because the producers of this country have to compete at the world price level, but the fact nevertheless remains that the weight of taxation is largely shifted to costs of production. Whether the producers recover their costs or not, was evidently immaterial to the Colwyn Committee. But a conclusion based on this defect was misleading, and it has been responsible, more than anything else, for a great deal of defective and expensive legislation. Politicians have erroneously concluded that further taxation could be imposed without prejudice to the productive industries of the country.

In paragraph 702, quoted above, the Committee suggest that the weight of taxation has a 'materially adverse effect on savings, but this does not hold good, so far as the receipts are applied to payments on account of the internal debt.' The reply to this observation is that the deposits of the British joint stock banks increased between December 31, 1919, and December 31, 1928, by £53,500,000 only, whereas in the United States they increased by £2,670,600,000 in the same period, which increase alone exceeds the total deposits of the British joint stock banks, the result of generations of work.

The Committee also suggests that 'if general conditions improve and times become more prosperous, the burden will be carried with comparative ease.' It is here suggested that, if a considerable increase of production is done within the country, the weight of taxation will be spread over a larger number of units of goods produced, thus enabling the productive industries to carry their burden 'with comparative ease.' With this view I entirely agree.

It is here, however, that I regret the Committee were not empowered to review the mechanism of the monetary system, for sufficient evidence might then have been

brought forward to prove that, whilst present monetary policy and free imports were maintained, it would be impossible for the basic industries to recover the weight of taxation imposed on them through costs of production. The quantity of money available for financing the national debt and productive industry and trade is fixed; without such evidence it was clearly impossible for the Committee to arrive at a clear conception of the issues involved, since all the factors that influence production and distribution were not brought under review. Production and consumption cannot be extended to the extent necessary to enable the producers to carry the weight of taxation, and redeem the national debt, if the mechanism of the monetary system is unable to provide the requisite credit facilities, and if free imports prevent the producers from offering to their bankers adequate eligible security.

Furthermore, the Colwyn Committee did not make any attempt to point out that, if labour recovers its share of the weight of taxation through wages—which are regulated in most cases by the Ministry of Labour Index on Cost of Living—the productive industries must not only carry their own share of the weight of taxation, but also that imposed indirectly on wages, through income tax, customs and excise, rent and municipal taxation.

Although the duty on beer and other indirect charges such as municipal rates, etc., are not included in the Ministry of Labour Cost of Living Index, yet it is clear that they are taken into consideration by the trade unions when they arrange their wages agreements with the employers. The trade union leaders may be relied upon to know the minimum subsistence wage a working-man's family can live on.

The following table shows for 'sheltered' and 'unsheltered' trades respectively the index numbers

of weekly rates of wages at December 31, from 1919 to 1927. Base: July 1914 = 100.

—	July 1914.	December 31.								
		1919.	1920.	1921.	1922.	1923.	1924.	1925.	1926.	1927.
Cost of living .	100	225	265	192	178	177	180	175	175	168
Index number of weekly rate of wages in 'unsheltered' trades	100	221	245	206	145	148	148	148	148	150
'Sheltered' trades .	100	216	274	242	197	190	197	198	198	199

(*Note.*—The wages taken are the 'weekly rate of wages' and are money wages and not real wages. The representative workers taken in the 'sheltered' trades are builders, railway workers, tramway workers, and local authority labourers; and the representative workers in the 'unsheltered' are the various classes of engineers and shipbuilding workers. Cotton operatives were not included, as the form in which information as to their wages is available does not make it possible to combine the data with the wages of engineers and shipbuilders. But the result would not be materially affected by their inclusion. It will be seen that wages in the sheltered trades were practically 100 per cent., and in the unsheltered trades 50 per cent., above their respective levels in 1914.)

In the above table it will be seen that the increase in the wages paid in the 'sheltered' trades since 1914 is practically 100 per cent. greater than the increase in the 'unsheltered' trades. If the retail distributing trades

were included, which are 'sheltered' trades, the position would not show much variation. As the 'sheltered' trades may be regarded as service or distributing agencies to the 'unsheltered' trades, it is clear that the former also largely succeed in shifting their burden of taxation to the latter's cost of production and distribution. In the particular case of the retail distributing trades, this will be done by offering to the home producers prices for their productions based on lowest international prices. Price always tends towards lowest cost, and, in the circumstances we are discussing at present, international costs and prices are the lowest.

In the unsheltered industries it is, of course, quite impossible for the workers and the employers to recover their weight of taxation through wages or prices, since they must offer their output in competition with imports at prices that do not include any portion of the weight of taxation. The loss in each case, therefore, has to fall on wages and costs, and thus it is easy to prove, under such trading conditions, that the weight of taxation is not shifted to prices. But it is also easy to prove that the weight of taxation must enter into costs, and that, consequently, the workers and employers concerned must suffer losses which, after the lengthy period of depression they have already gone through, they cannot afford.

When the weight of taxation is thrown on to costs of production, the latter become national costs and not international. To ensure the recovery of these costs, it is obvious that national regulations are required. The welfare of industry and trade thus becomes the concern of Government. If Government fails to regulate and ensure the essential working conditions that will enable producers and labour to recover the weight of taxation imposed, it perpetrates an injustice upon all those who labour.

In the Appendices to the Colwyn Report there is an

excellent article by Professor E. R. A. Seligman, the distinguished American economist. In his comment on special taxes on income, and a general tax on income, he writes as follows :

Where we have a series of special taxes on income, it is necessary to consider each class by itself. If we are dealing with ordinary competitive conditions, many such special income taxes will be shifted. If a tax, for instance, is imposed on the profits of a particular class of business, the tax will usually be shifted. The argument is analogous to that in the case of a special tax on the income of houses or on the income of moneyed capital loaned at interest. Why should the individual continue to keep his capital in a particular kind of business, subject to a special tax, if, by transferring his capital to some other field not subject to taxation, he can increase his net returns ? Such special taxes, therefore, tend to be shifted ; for otherwise the individual will withdraw his capital from that class of enterprise, and the consequent diminution of supply will inevitably lead to an increase of price.

The same argument applies, with certain reservations, to income from personal exertions—like wages and professional salaries. In the case of ordinary unskilled labour, if wages are near the minimum of subsistence, a special tax on wages (which in modern times is not found, because of the individual and family exemptions, in the general income tax) will be apt to be shifted in the first instance to the employer in the shape of higher wages ; and he in turn may be able to pass the tax on to the consumer in the shape of higher prices. Where wages are above the minimum of subsistence and enable the labourer to enjoy a higher standard of life, the question as to whether he will be able to shift the tax to the employer in the shape of higher wages, or whether he will have to bear the tax himself and thus suffer a reduction in his standard of life, depends upon many conditions which can be summed up under the head of the relative resisting powers of both parties. Under actual conditions, where the standard of life is tenaciously maintained, as in the United States, a tax even on the higher class of labourers will tend to be shifted. The same would be likely to be true of the earnings of the professional classes—like physicians, lawyers, architects, engineers, and the like. For, in the long run, if such classes were subject to an exclusive tax, it would, under conditions of free competition, lead to a gradual exodus to other occupations not subject to tax ; and this decrease in the supply would naturally

lead to an increase of the remuneration of those that remained. There are, indeed, exceptional cases where high professional earnings represent either monopoly returns or incomes that are fixed by custom rather than competition; and in such instances, like railway presidents and great surgeons, it is not at all impossible that, having already charged all that the traffic will bear, they would refrain from adding the tax to their charges or salaries. In the great run of cases, however, a special tax on professional incomes, like a tax on wages where the workmen are well organised, is apt to be passed on. . . .

In the main, then, a special tax on the income of particular classes, with the exception just noted, will lead to changed prices, either higher prices as in the ordinary case of shifting, or lower prices as in the case of land or of securities where the tax is capitalised rather than shifted. Inasmuch as the individual business man ordinarily thinks of himself in the light of one who is subject to special taxation, it is natural that he should generalise the above conclusion and hold that income taxes, like so many other taxes, are shifted to the purchaser in the form of higher prices.

As a matter of fact, however, the situation is different when we deal with a general income tax such as our federal income tax. If everyone is taxable upon his income, from whatever source derived, there is no taxless field to which he can repair. If he pays the tax in the first instance, he cannot improve his position by transferring his capital and his energies to some other business or occupations; for he would meet in the new enterprise precisely the same conditions, so far as the tax is concerned, as in the old one. How then can such a change in the relations of demand and supply be brought about as to render possible a shifting of the tax or an increase of price? If the tax is on professional earnings there will be no exodus from the profession because there will be no resulting improvement to the taxpayer. The recipient of income from houses or from interest on capital will not be led to diminish his investments, because in whatever new fields he might be tempted to invest, he would suffer the same burden. The business man, subject to a general income tax, would also be in precisely the same predicament; so that in the case of a general income tax there is no difference, as before, between conditions of monopoly and conditions of competition.

I have already answered several of the points raised by Professor Seligman. He omits, however, to mention that where a general income tax is increased, and in cases

where they have the power, prices will be increased to an extent sufficient to produce the same net income as before. The increased income will then be taxed, but it should be noted that the tax will have already been passed on before the income becomes subject to tax. In such cases, it is unlikely that income tax would be passed on again!

Income tax in special cases is shifted to prices, and in the majority of cases, such as the basic industries, to costs of production. The latter then become national costs and not international. In so far as Great Britain is concerned, the changes in demand and supply will be affected by free imports of foreign goods which do not bear the same weight of taxation. Therefore, it should be borne in mind that Professor Seligman's review presupposes stable national working conditions such as exist in the U.S.A. If his argument is to be sustained, it should be based on the same premises in both cases.

America and France have stable internal working conditions, and they control between them about half of the world's gold supplies. They are able to issue to their industries and trades credit facilities at the lowest rates of interest in the world, due to the fact that the internal trades of these countries are not interfered with by free imports. It may be said in passing that the gold reserves and foreign currency controlled by the Bank of France to-day approximate £644,000,000, a most remarkable state of affairs when we bear in mind the collapse of the franc a few years ago. How has France been able to make this extraordinary recovery? Simply by employing gold exclusively for convertibility purposes, and re-discounting internal bills of exchange freely at the Bank of France. This policy has succeeded so well that the currency in circulation in France to-day exceeds the currency in circulation during the height of the inflation of her currency.[1]

I am glad to see that Professor Henry Clay, the

[1] See pp. 202–3.

distinguished Free Trade economist, supports my thesis that taxation is shifted to industry. He writes as follows in his excellent book, 'The Post-War Unemployment Problem':

> Taxation and trade depression constitute a vicious circle. Taxation is increased to meet the distress caused by depression, and recovery is delayed by the weight of taxation.
>
> The Treasury is not merely a tax-collecting machine; it is the organ through which the Government takes into consideration the total effects of Government policy upon national economic activity.

The only solution of the weight of taxation that Professor Clay can suggest is a more extensive adoption of rationalisation within the basic industries, and the issue of capital securities on behalf of these industries by London issuing houses. In the preface to his book, Professor Clay tells us that one of his objects is 'to discourage the hope that the problem, if left to itself, will cure itself, and to argue that the necessary organisation of the depressed industries will not be effected unless the initiative is taken and the impulse given by some agency outside them.'

This work is now being undertaken by the Bank of England's Securities Trust. Professor Clay is now identified with the Bank of England. But it is impossible to rationalise businesses on the verge of bankruptcy; before this can be done, it must be possible for them to do business at a profit, and the same argument will hold good with regard to the suggested issues of industrial securities. The only security an industrial firm can offer to the public is the profit it earns; without this, its assets become liabilities. It is for the Government to take 'into consideration the total effects of Government policy upon national economic activity.' The best work that the Bank of England could do would be to agree to an improvement being effected to its Central Banking mechanism in such a way as would accord with modern Central Reserve Banking practice. In developing

its Securities Trust, it is embarking on a business, through a subsidiary company, which it has no right to undertake. Industrial groups favoured with its patronage would be certain to receive a preference in the granting of credits within the extremely limited resources now available ; and this, combined with its rationalisation policy, would place those competitive industrial groups, anxious to pay their way and their creditors in full, at a serious disadvantage. The Bank of England has not the capital resources, nor the credit facilities, to do justice to the problem which it has commendably undertaken to solve.

In every industry it is the last 25 per cent. of the production that is sold that determines the measure of profit and loss of the first 75 per cent. If each of the basic industries are, therefore, only operating to 50 per cent. of their capacities, if they have in addition to carry the weight of taxation on this low output, and if they have to compete at the world price level, which leaves no margin for the weight of taxation, then obviously it must be difficult for the majority of the producers in the basic industries to remain solvent.

From a national point of view, approximately 80 per cent. of all industrial production is profit ; and 100 per cent. of all agricultural production is profit. The commissions and profits earned on the turnover of foreign imports by merchants cannot exceed 3 per cent. on an average, and as the profits that could be earned by retailers would be approximately the same in handling home productions in preference to foreign, there can be no advantage to the nation in permitting the free entry of foreign imports if they do not contribute their fair share to the weight of taxation.

It can safely be said that income tax imposed on income receivable from foreign investments is not shifted to the cost of producing the commodities that are imported.

To the extent that the weight of taxation is not recovered in 'price,' to that extent does it become a dead loss to the nation, which loss is adjusted at the expense of its accumulated capital. This loss diminishes savings, and thus reduces effective demand.

The nation represents the total potential productive power of the country. The principles that govern the conduct of individual businesses ought certainly to govern the conduct of the nation's business by Government.

With regard to the income tax and super tax imposed on income received from the ordinary dividends of industrial and commercial undertakings, these quite clearly, and as I have previously indicated, are not passed on into costs of production ; but as they cause a shortening of purchasing power and savings, they curtail effective demand ; and as effective demand diminishes, the cost of producing what remains must increase, so that indirectly such income tax and super tax do increase costs of production.

If sound credit originates in production and terminates in consumption, then it is clear that if 70 per cent. of our present credit originates in securities composed mainly of debts, the weight of taxation that is imposed must fall largely on the remaining 30 per cent. There is, of course, a substantial recovery made of the taxation imposed on the interest paid on the national debt and other securities, but it is simply an in-and-out transaction, and thus it becomes a pretence at paying taxation. Taxation on interest receivable is effective only in cases where the rate of interest is fixed, *i.e.* where the rate is not increased after the taxation is imposed. The customary practice, whenever the income tax is increased, is for lenders to cover themselves by increasing the rate of interest on all money lent or renewed ; and this tends to depreciate the market value of all outstanding securities where the rate of

interest is fixed. Income tax deducted from dividends declared on ordinary shares is effective and is not shifted to costs of production ; but here again, and in our present monetary and industrial system, it diminishes savings and purchasing power, which in turn diminishes effective demand.

Thus, we see that the weight of taxation imposed on all new financial business of whatever kind is shifted, *i.e.* the net weight of national and municipal taxation falls largely on costs of production. The moral to be drawn from this is that Governments cannot relieve poverty and distress through taxation, whilst maintaining a monetary system that is theoretically based on gold. Taxation is simply confiscation, and no economic system can prosper by such means. Taxation is effective provided it coincides with a low costs level and cheap money. It is disastrous otherwise.

With proper mechanism, I do not say that taxation is undesirable or avoidable. The business of Government and of social amelioration must be carried on. What I do say is that the only way in which we may avoid excessive taxation, and bring about an equitable distribution of wealth, is to have cheap money. The only way in which we may have cheap money is to extend production, for production alone creates cheap money. And when we have cheap money, the Government, and above all the productive industries, need not pay exorbitant rates for its use.

Income tax deducted from dividends receivable from our foreign investments, and commissions earned on foreign business, is not shifted to national costs of production. But these foreign dividends and commissions could not be receivable unless there was a substantial excess of imports over exports ; in other words, unless the system of Free Trade was maintained. To the extent that foreign imports displace national

production, to that extent does it proportionately increase national costs of production and unemployment. A case is here clearly established for a redistribution of the weight of taxation so that foreign imports may bear their due proportion of the weight of taxation. For as foreign investments increase, and as the income from these investments increases, so must the excess of imports over exports increase. This tendency must throw a gradually increasing burden on the remaining production that has to be done within the country. I am not here attacking the principle of foreign investments so long as these do not tend to restrict the credit available to home producing industries, and diminish national production and consumption. This is indicated in Chapters X and XXII.

Notes to Chapter XI

Since the foregoing chapter was written, several events bearing upon the subject under discussion have happened. In the U.S.A. and France, further remissions of debt and taxation have been made from Budget surpluses, whereas in Great Britain, taxation has been increased in order to balance a Budget deficit.

In view of the altered rates, the following comparisons of the weight of Income Tax, and Income Tax plus Surtax, on a single man, and a married couple with two children, in Great Britain and the United States of America, should prove to be of general interest. It shows how purchasing power, which ordinarily would be saved, or spent in consumption, is being unduly diverted to Government revenue :

Income Tax

Earned Income	Single Man		Married Couple with two Children.	
	Great Britain	U.S.A.	Great Britain	U.S.A.
£	£	£ s. d.	£	£ s. d.
800	88	1 16 10½	43	—
1000	126	2 11 10	81	8 9
1500	220	8 12 7	175	2 6 3
2000	332	16 17 0	287	7 10 0
3000	557	46 17 0	512	29 11 9½
4000	782	76 17 0	737	59 11 9½
5000	1007	142 9 3	962	119 9 0

Income Tax plus Surtax

Earned Income	Single Man.		Married Couple with two Children.	
	Great Britain	U.S.A.	Great Britain	U.S.A.
£	£	£ s. d.	£	£ s. d.
800	88	1 16 10½	43	—
1000	126	2 11 10	81	8 9
1500	220	8 12 7	175	2 6 3
2000	332	16 17 0	287	7 10 0
3000	613	57 10 8½	568	40 5 6
4000	938	117 13 5	893	100 8 2½
5000	1313	237 13 4	1268	214 13 1

The economic policy pursued by the United States Treasury is summed up in the following aphorisms taken from a book entitled

'Taxation: the People's Business,' written by Mr. Andrew W. Mellon, the Secretary to the United States Treasury, as follows:

I have never viewed taxation as a means of rewarding one class of taxpayers or punishing another. If such a point of view ever controls our public policy, the traditions of freedom, justice and equality of opportunity, which are the distinguishing characteristics of our American civilisation, will have disappeared, and in their place we shall have class legislation with all its attendant evils.

It seems difficult for some to understand that high rates of taxation do not necessarily mean large revenue to the Government, and that more revenue may often be obtained by lower rates. There was an old saying that a railroad freight rate should be 'what the traffic will bear'; that is, the highest rate at which the largest quantity of freight would move.

High taxation, even if levied upon an economic basis, affects the prosperity of the country, because in its ultimate analysis the burden of all taxes rests only in part upon the individual or property taxed. It is largely borne by the ultimate consumer.

High taxation means a high price level and high cost of living. A reduction in taxes, therefore, results not only in an immediate saving to the individual or property directly affected, but an ultimate saving to all people in the country.

Some inflation, however, was unavoidable, for loans, so far as they are not paid out of savings, but by the banks or by individuals with advances from the banks, lead to inflation; and likewise taxes on income, so high that business is forced to borrow from the banks in order to make payment, also add to inflation.

A bonus or subsidy can be paid only by taking money out of the pockets of all the people in order that it shall find its way back into the pockets of some of the people.

The adoption of a sound system of taxation will have a favourable effect in many directions. It should help to solve the housing problem, to make possible lower freight and passenger rates by getting the railroads back on an efficiency basis, to increase savings due to the reduction of taxes on earned incomes and the lower brackets and thereby to increase the buying power of the earning class and to raise its standard of living. It will also promote industrial and business activity by diverting into productive enterprise funds which are now going into tax-exempt securities. This should increase the number of jobs and at the same time advance general prosperity.

CHAPTER XII

DOES DIRECT TAXATION FORCE A REDISTRIBUTION OF WEALTH ?

If direct taxation largely enters into costs of production, then it cannot bring about an equitable distribution of wealth. On the contrary, whilst our present monetary system is maintained, it must bring about a diminution of wages, or of employment, since this is the only item in costs of production which the producers directly control. On the other hand, certain economists assert that direct taxation does force a redistribution of wealth and therefore cannot be said to enter into costs of production. As this is a vital and fundamental issue, it must be thoroughly examined with a view to clarification.

The first question that has to be asked is, What is wealth ? When we talk of the 'wealth-productive power' of the country, we use a phrase that provides the answer. 'Wealth' is in reality income, and 'productive power' is capital, and the volume of wealth which our productive power is capable of producing will depend on the efficiency of the latter. Many people confuse the term 'wealth' with 'capital,' but if care is exercised in drawing the distinction which should be drawn between them, a clearer conception of the problem to be solved will be obtained.[1]

I am definitely of the opinion that direct taxation—excluding that portion derived from foreign investments—does not redistribute wealth. The national wealth produced, being income, can only be effectively distributed through rising wages and falling prices. In this way only can the benefits which accrue from the

[1] For a clearer definition of wealth, see pp. 83, 86 and 159.

improvements effected in the arts of production be passed on to the consuming public, and the only vehicle through which it is possible to do this successfully and effectively is the currency, including bank cash.

If it is true to say that direct taxation does not redistribute wealth, and that it is largely shifted to costs of production, then the moral is that taxation should not be resorted to, except to defray the bare cost of the administrative services of Government, which should be on the most economical basis possible.

Now let us examine this problem more closely. If a person holds £100,000 4½ per cent. Conversion Loan, he is considered to be wealthy. But, when the Government issued the Conversion Loan, they created a debt which has to be redeemed by the tax-payers. The holders of this debt are entitled to be repaid in cash in 1940. In subscribing for the Conversion Loan, the subscribers transferred to the Government the cash or credit which entitled them, in the immediate present, to a claim on the wealth produced by the country. Those who subscribed for Government Securities during the War did so with the aid of bank credit which was ultimately blown into the air. But the watered credit still remains. Many of the War loans have matured for payment, but these have been renewed on practically the same terms and conditions. These loans are certainly not wealth, but the securities representing them may be termed capital by the holders thereof.[1] The asset they own is a claim to a share of the wealth products created by the country in, or after, the year 1940.

If a person holds £100,000 of agricultural land, or other real estate property, here again he possesses an asset which is termed fixed capital. If the properties produce no revenue, their marketability and liquidity is not as good as the securities representing Government debt, on which the interest is guaranteed by the State.

[1] For extension of argument see p. 221.

In fact, if real estate properties produce no revenue, they cease to be assets and become liabilities because they have to be maintained. But in real property classifications have to be made. Agricultural land and factory premises and plant are wealth productive ; they are, in fact, the means of production. Office property and houses are revenue producing, but the capacity of the tenants to pay rent—the same argument will apply to owners—will depend upon the value of their personal earning capacity in the production or distribution of wealth. Such services are paid for in wages, *i.e.* money, according to merit, which money is a claim on the mass of wealth products produced or imported into the country.

When we talk of the wealth productive capacity of the country, we talk of the consumable commodities or utilities which it is capable of producing and exchanging. The cost of producing these will depend upon the efficiency of the means of production ; consequently the latter cannot be regarded as wealth, but as capital. Wealth is, in fact, income, which can be transferred into capital ; and capital can be transferred into wealth, just in the same way that credit can be transferred into gold, and gold into credit. Capitalists live on their income, and, if they can avoid it, certainly not on their capital. They would regard it as unsound finance to live on their capital. This salutary principle is also accepted by producing capitalists, and should certainly be accepted by Governments.

Now let us assume that the person who holds £100,000 4½ per cent. Conversion Loan dies, and that those who inherit his estate are forced to give up £50,000 to the Government by way of Death Duty. What does the Government do with the proceeds receivable from the sale of this capital? It uses it as revenue, *i.e.* income. But when the Government absorbs income in this way, it is not redistributing wealth. What happens is that it forces the inheritors of capital—either in the form of

debts or real property—to realise their assets on the market, the cash proceeds of which are handed to the Government, which in turn distributes them through pensions and doles. The money thus distributed entitles the recipients to an immediate claim on the existing wealth products, *i.e.* income of the country. In other words, the Government has converted a claim for £50,000 due in 1940 on the then available wealth, to an immediate claim on existing wealth, and to this extent has destroyed the nation's immediate wealth exchangeable capacity. The recipients of the Government doles and pensions thus consume without creating. There has, in fact, been no barter exchange of commodities and services for commodities and services.

Now let us take the case of an owner of agricultural land or factory premises and plant. On the death of the owner, let us assume that the Government claim 50 per cent. to cover the Death Duty. This will necessitate a transfer, firstly, of all the liquid capital held by the estate, and, secondly, a sale of part of the property held. This will involve a break-up of the means of production, the efficiency of which is best maintained by their present owners. In some cases trustees endeavour to retain their estates intact by borrowing, on the security of the property inherited, a sum sufficient to cover the Death Duties. But the interest payable on the loan thus obtained becomes a charge on the costs of production of this particular estate.

Whatever the means that are employed in transferring cash to the Government from the sale of capital, the latter, upon receipt of it, spends it as revenue.[1] In

[1] Touching upon this point, the following extract, taken from the Minority Report of the Colwyn Committee (p. 417), will be of interest: 'Even where estates are sold to meet the duties, capital is only transferred, not destroyed. The property sold must eventually be bought by someone who has free income seeking an investment, and the only effect is to divert this income from the creation of a new, to the purchase of an existing, investment. There is no reduction of actual capital.'

In this quotation, the writer does some confused thinking. If the property

doing so, it is living on the nation's capital, and not on the income produced by the capital. If it employed these particular cash proceeds in the discharge of debt, this argument would not apply. But this would not involve a redistribution of wealth in the sense which Socialists mean. Let us follow this argument a little further.

Let us assume that the estates involved do not create loans for the purpose of paying the Death Duty, but instead choose to pay over their available liquid cash, and sell part of their property to obtain the balance of the cash required. The wealth productive capacity of the remainder of the assets is destroyed. If producers are to retain the efficiency of their means of production, they must be allowed to retain their liquid wealth (cash), in order to be able to pay for and buy those materials and services which are necessary for the production of wealth. The standing and credit of producers are determined by the volume of liquid wealth they may possess; and, likewise, the value of their fixed capital is determined by the percentage of liquid wealth held in relation thereto, and employed in the conduct of their businesses.

Capital and wealth may therefore be defined as follows:

CAPITAL

Deferred Capital.—Future claims on wealth production due to money lent for fixed periods, the market-

is sold to someone possessing a free income, *i.e.* free cash resources, the Government, by absorbing the income, prevents the existing capital of the country from being increased. It must prevent savings from accumulating. If the capital of the country could be increased, it would surely give to the country a chance of increasing its income, subject, of course, to the existence of a correct monetary policy. It is absurd to suggest, in order to justify the theory that taxation redistributes wealth, that the purchase of an old investment is as good as the creation of a new one. A Government has no justifiable right, unless it be for the specific purpose of redeeming debt, to impose taxation upon anything other than the current income of the year. All else must be capital, and taxation derived from capital sources should certainly not be spent as revenue by Government.

ability of which is determined by the interest yield and the prospect of payment, both as regards capital and interest.

Personal Capital.—The productive or service power of individuals.

Fixed Capital.—Land, buildings and machinery.

Wealth (= *Income*)

Manufactured utilities, agricultural produce and minerals, including gold, which have an exchange value, *i.e.* cash value.

From the above classification it will be seen that wealth is, in fact, income, from which we infer that in order to extend the nation's income, we must maintain and preserve the means of production and their efficiency. In discussing this matter, Frederick List wrote as follows :

> The causes of wealth are something totally different from wealth itself. A person may possess wealth, *i.e.* exchangeable value ; if, however, he does not possess the power of producing objects of more value than he consumes, he will become poorer. A person may be poor ; if, however, he possesses the power of producing a larger amount of valuable articles than he consumes, he becomes rich.
>
> The power of producing wealth is therefore infinitely more important than wealth itself ; it ensures not only the possession and the increase of what has been gained, but also the replacement of what has been lost. This is still more the case with entire nations (who cannot live out of mere rentals) than with private individuals.

In so far as it concerns Great Britain, I should express List's excellent proposition in the following way :

> Wealth is something totally different from capital. A person may possess capital, *i.e.* a saleable asset ; if, however, he does not possess the power of producing objects of more value than he consumes, he will become poorer. A person may be poor ; if he, however, possesses the power of producing a larger amount of valuable articles than he consumes, he becomes rich.
>
> The potential productive power of the country, *i.e.* its means

of production, personal services, and their efficiency, is therefore infinitely more important than its deferred capital, or its merchant trade. The power of producing wealth ensures not only the retention, and an increase, of what has been gained, and the replacement of what has been lost, but also the redemption of the national debt. The nation cannot live out of the proceeds of mere rentals, or the commissions gained on its merchant trade. These alone are not sufficient to redeem the debt, or pay the onerous burden of taxation imposed.

The potential wealth productive power of a nation can only be built up through infinite care, sacrifice, enterprise and energy. The power that exists has taken generations to evolve, and gold could not replace it. A mistake in the attitude or judgment of Parliament, resulting in any measure of legislation likely to prejudice the future wellbeing of the nation's productive power, may well destroy in a short space of time what has taken centuries to build up.

It has been stated on good authority that in the heavy woollen industries in the Bradford district, 532 trading firms have gone bankrupt, or passed out of business, in the last few years, and many were of old standing. This destruction of the nation's productive power has been quite clearly due to parliamentary legislation.

It is a true economic principle which states that those countries are most prosperous where taxation is lowest and productive power is greatest, whether it be in industry or agriculture. As this is true, we cannot logically assume 'that taxation is beneficial because it forces a redistribution of wealth.' As I have shown, a distinction must be drawn between what is wealth and what is capital.

The marketable capital value of the means of production, or of deferred capital, will entirely depend upon their income, which income is in fact that part to which they are entitled from the wealth products produced and exchanged by the country in the immediate present;

certain fixed and deferred capitals may have no income, but they acquire a value if they have a prospective income. The value of all fixed or deferred capital, or any article of utility or adornment, disappears at starvation point. From this we infer that the farther we get away from starvation point, the greater will be the value of all things that have a value.

If unemployment, poverty and distress prevail within the country, it is obvious it cannot be relieved permanently by forcing a sale of deferred or fixed capital, or of diamonds, gold, and jewellery. What people want most are the necessaries of life, but they cannot have them until they are produced. The most obvious thing to do is surely to produce them? Why impose taxation when potential productive power exists? God has placed an abundance at the disposal of His people without any limitation beyond that of work. Its distribution is retarded through the limitations imposed by man himself.

Therefore, when people talk of redistributing wealth through taxation, an intelligent understanding of the problem will depend upon whether they have in view income or capital. They usually mean a redistribution of capital, which, in so far as it has proceeded, has proved fatal to the best interests of the community. What we have to concern ourselves with in future is how to bring about an effective distribution of real wealth, *i.e.* income. This is best achieved through increasing wages and falling prices, both of which ideals are contingent upon the correct monetary technique being employed. I have described this as the 'Dual System of Stabilisation,' which I believe will do more to advance social progress than any other instrument yet discovered.

Under the 'Dual System of Stabilisation' unemployment and poverty will be things of the past. The full benefit of all improvements in the arts of production

will pass on to the public through wages, prices and income, and the more people that are employed, the richer will the country become. The more that people work, the greater will be the income of everyone, and no longer will employers be compelled to reduce wages because more people are looking for employment than there is work for them. Further, as the arts of production improve, and the quantity of production increases, the shortening of the working week, without decreasing wages, will be the scientific corrective for unemployment. We cannot divide until we produce, and the more we produce, the more we can divide. When we reach this stage, we can afford to concede more leisure.

Taxation is essential to cover the cost of the administrative services, and all those measures which aim at social amelioration, such as incapacity, unemployment, old-age and widows' pensions ; but, if a sound economic system exists, it is not essential to impose taxation in order to find pensions for able-bodied men. All should render service to the utmost of their capacity, and all able to work should be able to find employment,

If it is agreed that the monetary system should be the servant of production, then it must be a paradox to suggest that money should be allowed to continue to control trade prices through the existing methods of expanding and contracting credit, which methods originate ' inflation ' and ' deflation.' Unless existing monetary practice is altered, it must always remain the master of production and consumption, and prevent an equitable distribution of wealth ; and it must also ensure a perpetuation of the principle of taxing capital, which, to those who seek relief, will be the only alternative remaining. Labour has a grievance, and it feels that, at any rate, it must continue to try and force a redistribution of existing capital—which it erroneously calls wealth—a method, as I have shown, that reacts with prejudicial results on all parties concerned. The

one and only substitute for direct and indirect taxation is to create more wealth, and the more we create, the more we can divide. In this way only can peace, contentment and prosperity be brought to the land.

. . . . . .

I will now endeavour to summarise the argument in the preceding chapter and this one. When income tax and super tax is imposed, those individuals who have to pay these taxes endeavour, by every legitimate means, and where they have the power, to shift them to overhead expenses, *i.e.* to costs of production. Specialists will only accept employment nowadays provided they receive a salary large enough to cover their liability under the taxes mentioned and the standard of living they are accustomed to—or desire to attain. The equivalent of a pre-war salary of £5,000 is to-day £10,000, and the difference is certainly shifted to costs of production.

Where the income and super taxes cannot be shifted, they diminish savings, spending power and employment; and even where they are shifted, they do the same. As will be seen from the comparative tables on p. 79 which show the income tax and super tax payable by British and American taxpayers, the Americans can afford to run motor cars with the greater income they retain. In the larger cases, the difference is large enough to enable them to employ servants and gardeners in addition if they so wish it.

Furthermore, to the extent that direct taxation diminishes savings and forces the transfer of capital abroad, to that extent does it limit the capacity of the joint stock banks to lend. And as the bulk of the credit which they create in any event originates in Government Securities, so the volume of credit available for production becomes a gradually diminishing quantity. We have also to bear in mind that the volume of currency has been substantially diminished since 1920.

Thus producers and labour suffer in the following ways:

(1) In cases where taxation is shifted to overheads, from an increased cost of production which diminishes competitive power.

(2) From the fall in the price level, brought about by a shortage of credit and currency for production, which necessitates the delivery of more commodities than were necessary in 1920 to satisfy claims for taxation and interest.

(3) From a diminution of wages in order to neutralise as far as possible the increase in costs and the fall in the price level, which no possible increase in industrial efficiency can wholly overcome.

(4) From a decrease of consumption brought about by a diminution of wages and income.

(5) From an insufficiency of credit for productive purposes, and/or from an inability to employ it profitably when obtainable.

(6) From a tendency for costs of production per unit of goods produced to increase, as the volume of production diminishes, for reasons stated.

(7) From the increase in the number of unemployed, who are potential customers out of work, with the consequent reduction in output and increase in unproductive national expenditure on doles and insurance.

(8) From a transfer of the domicile of British subjects to foreign countries, so that they may escape the onerous burden of taxation imposed in this country.

(9) From the investment of British capital abroad where it can find more profitable employment, with some of the consequences outlined in items (1) to (6).

(10) From an increasing excess of imports over exports, largely due to the high costs level prevailing in this country—which are in effect national costs—and partly to the greater income we are receiving from abroad on our foreign investments.

The truth is that the imposition of income and super

taxes has a general blanket effect. We can prove that they are largely shifted to overheads, thus directly increasing costs ; and that where they are not so shifted they cause a decrease of employment and consumption, thus indirectly increasing costs.

Popular opinion is correct when it asserts that an increase of taxation diminishes trade activity and employment ; and that a decrease of taxation promotes them. Some economists infer, of course, that as direct taxation is redistributed in the form of interest on war debt, and in doles, the foregoing arguments cannot possibly be effective ; and that what the Government does is merely to redistribute the spending power which it collects, so that we remain as we were. The answer to this inference is that what the Government does is merely to redistribute claims to bank credit and to currency, both of which are based theoretically on gold, but in reality mainly on securities, *i.e.* claims to capital. Where taxation is shifted to costs, it is in effect transferred to capital account—but if profits are earned the fact will be concealed—and in the long run this will lead to a drain of liquid capital and reserves, and a resort to bank credit, which will ultimately lead to the bankruptcy of many concerns. We need only look round to see how agricultural land and many factory premises are being sold up to meet their liabilities ; although it is being said by way of excuse that the root cause is over-production. There never was a greater travesty of the truth.

The Government taxes capital and wealth, but demands payment in money. The producers create wealth but not money. It is the old argument of 'price' and 'value' over again. The quantity of money (money = currency and credit) is not taxed ; so that when the Government collects the money it merely returns it to its source ; and then the process begins all over again ; but

as each year passes by the poverty increases. So long as the money which the Government redistributes is mainly bank credit, it will conceal the poverty of the present system. Had the money been retained by the original owners, it would no doubt have been used to greater national advantage, and in a way that would have brought about an increase of home production and employment. The fact remains, however, that the Government must impose taxation in order to cover Budget expenditure. But only the Government can determine the form in which its revenue shall be collected. Little did Adam Smith realise that, in this enlightened age, we should be reduced to the absurdity of attempting to prove that consumption—and not taxation—was the sole end of all production.

Everyone should contribute to the cost of Government in proportion to their income. But a wise Government would be that which would aim at increasing everyone's income, for then all the taxation which is imposed could be collected with greater facility and ease. A greater revenue would also be assured to a Government if it lowered taxation with a view to promoting an increase in trade activity and inducing an increase in the revenue. In other words, a Government should aim to take as little as possible in the form of taxation out of income, and the income it taxes should be that of the current year only. All else is capital, and no Government has a right to tax capital with a view to spending it as revenue, unless it be for the specific purpose of redeeming debt. And the most effective way of redeeming debt is out of Budget surpluses, when these are available.

I should now like to quote Ricardo in support of my general thesis :

> If we had then an invariable standard, by which we could measure the variation in other commodities, we should find that the utmost limit to which they could permanently rise, if produced

under the circumstances supposed, was proportioned to the additional quantity of labour required for their production ; and thus unless more labour were required for their production, they could not rise in any degree whatever. A rise of wages would not raise them in money value, nor relatively to any other commodities, the production of which required no additional quantity of labour, which employed the same proportion of fixed and circulating capital, and fixed capital of the same durability. If more or less labour were required in the production of the other commodity, we have already stated that this will immediately occasion an alteration in its relative value, but such alteration is owing to the altered quantity of requisite labour, and not to the rise of wages.[1]

A well-regulated paper currency is so great an improvement in commerce that I should greatly regret if prejudice should induce us to return to a system of less utility. The introduction of the precious metals for the purposes of money may with truth be considered as one of the most important steps towards the improvement of commerce and the arts of civilised life ; but it is no less true that, with the advancement of knowledge and science, we discover that it would be another improvement to banish them again from the employment to which, during a less enlightened period, they had been so advantageously applied.[2]

As I understand the proposition stated by Ricardo, it is this : that 'if we had an invariable standard, by which we could measure the variation in other commodities,' and 'a well-regulated paper currency,' we should be able to eliminate inflation and deflation from the industrial system. The argument in the first quotation also presupposes that any rise in wages will be uniform. But as it is also relevant to the conditions of to-day, it does not affect the broad principle involved in the argument.

When the currency in circulation is based on the mass of commodities through bills of exchange, we shall acquire an invariable standard 'by which we can measure the variation in other commodities.' And when the

[1] Extract from the works of David Ricardo, chap. i., s. iii., p. 20.
[2] *Ibid.*, s. iv., p. 404.

Government collects its taxation in money of this character, it will then begin to bring about an effective reduction of debt and taxation, and an increase of employment ; but not until then. We cannot redistribute wealth until the currency in circulation really represents wealth, and not largely a fiduciary issue. And when the currency really represents wealth it will not be necessary to try and force a redistribution of wealth through taxation. This will be more effectively achieved through rising wages and falling prices, and, in so far as it may concern charitable, religious, and philanthropic institutions, through the private benefactions of rich men. Furthermore, whenever the workers realise that the more they produce, the more they can divide, they will certainly have no objection to working harder and producing more, for they will know that the benefits to be derived from reducing costs will be passed on to other consumers. Henry Ford truly remarked that 'production was service power.'

When the poor and the rich are made richer, they will both have more to subscribe to the arts, social, religious, and philanthropic institutions, and to give in charity. It ought not to be necessary for a Government to resort to taxation to make good the shortage of private benefactions. All our social difficulties and political misunderstandings have arisen out of the defects of monetary policy. There is, of course, an exception to every rule ; but I cannot believe for one moment that there is an inherent viciousness in humanity. The violence of opinion which exists in many quarters at the moment is merely a reflection of the despair that is born in many souls, and the feeling that there is no way out but that of destruction. It is the mechanism of the economic system that is at fault, and it is certainly not the good will or soul of man.

Notes to Chapter XII

The cardinal fact remains that we can only increase the competitive power of the exporting industries in world markets by lowering and redistributing the weight of taxation, *i.e.* if we are to avoid continuing to make production unprofitable and if we are to avoid the necessity of lowering wages. Likewise, the drain on the gold reserves held by the Bank of England can only be diminished by increasing the competitive power of the exporting industries. The credits which these industries could create in foreign markets would be equivalent to gold, since they would eventually come under the control of the Bank of England, thus enabling it to counteract the foreign demands for gold, maintain with ease the parity of the foreign exchanges and the convertibility of the currency.

Another way by which we may decrease the drain on the gold reserves, and, at the proper time, augment the capital available for investment in productive enterprises in England and the Empire, is through a realisation of part of our foreign investment. But this will only become possible when it is worth while, and it will only be worth while when the investor is assured of three things : (1) Economy in Government expenditure, and (2) import duties on manufactures and certain agricultural products on a scientific basis, and (3) a reform of monetary policy.

A lowering of the weight of taxation can only be effected through a remission of taxation, to effect which substantial Budget surpluses are necessary. The only effective ways by which substantial Budget surpluses can be created, without increasing the rate of taxation, are as follows :

(*a*) By weighting foreign imports of manufactures and certain agricultural products with import duties. A transfer of part of the weight of taxation to import duties brings about an effective redistribution of the weight, since import duties—scientifically applied and subject to a reform of monetary policy—are neutral in effect on costs of production.

(*b*) By increasing the volume of internal production, to facilitate which import duties are essential, so that the internal weight of taxation, which is largely shifted to costs of production, may be spread over the larger number of units of goods produced.

(*c*) By increasing the profit-earning capacity of industry and

trade, which will be brought about by the foregoing measures, so that each shilling of the income tax will produce a larger revenue.

The economic policy outlined would undoubtedly contribute towards a substantial reduction of unemployment, which in turn would bring about a substantial reduction in the cost of the social services. At the present time, these cost about £426,000,000 annually. The Unemployment Insurance Fund alone is in debt to the extent of £60,000,000, an increase over the previous year of £30,000,000, which increase is included in the cost of the social services.

CHAPTER XIII

ON CENTRAL RESERVE SYSTEMS

In the *Economic Journal* for December 1929 there is published the address that was read by the Governor of the South African Reserve Bank, Mr. W. H. Clegg, before Section F of the British Association, which held its annual meeting at Johannesburg in August 1929. The address is extremely interesting and apposite to the present discussion. Mr. Clegg gives a short review of the motives which inspired those who conceived the formation of the South African Reserve Bank, and, in non-technical language, he sets forth the main provisions of the Currency and Banking Act that was passed, and of these the following two are important :

(5) The conditions under which notes may be issued conform to the American rather than to the English model. Notes have to be covered by not less than 40 per cent. of gold, and the remainder by trade bills. In England, the system is taht a certain amount—called the fiduciary issue—may be covered by securities and everything above that has to be covered by gold. The English system has been criticised as not allowing room for sufficient expansion. Whereas in South Africa or the United States the central bank can issue £100 notes for every £40 of gold in its possession, in England the central bank can issue only £100 in notes for every £100 of gold. As against this it has to be remembered that in the reverse process of contraction the English system has the advantage in that for every £100 of gold withdrawn it has only to withdraw £100 of notes, whereas in South Africa, or the United States, the central banks have to withdraw £250 of notes for every £100 of gold withdrawn. The fact of the matter appears to be that for countries which produce large amounts of

raw materials, such as South Africa and America, and which consequently are liable to require a large increase of currency in the harvesting season, a quickly expanding system is the better, whilst for a country like England, which lays itself open to large and sudden demands for gold, a less elastic system is the better.

(6) Under the Act the powers of the bank are very carefully defined, both as to what it may do and as to what it may not do.

Besides issuing notes and discounting three-months trade bills, the bank is allowed to do none of the main ordinary business of an ordinary banker. It may not make advances upon mortgage of fixed property, it may not allow interest on deposits, it may not grant unsecured overdrafts. It may not make advances on ordinary Stock Exchange securities, nor even on Union Government Stock, unless the stock is due to be repaid in a few months' time.

It might be thought that the idea of the framers of the Act was to make the bank a central bank according to the purest central bank theory. Such a bank, regulating the currency and credit of the country through the re-discounting of three-months trade bills for the commercial banks and for the outside market, and not in any way competing with the commercial banks, would be the beau-ideal of the enthusiast for the central bank theory.

I do not think, however, that this was the motive of those who framed the Currency and Banking Act. If you examine the charters of the various new central banks which have come into existence since the War, you will find a great likeness between them. And the reason for tying them down to very restricted powers is fairly obvious. *A central bank, if properly directed, should be a powerful instrument for good ; but if it was in the hands of people who were unaccustomed to central bank ideals, and who wanted to run the bank for profit rather than for service, or if it came too much under the influence of a Government who were imbued with the popular idea that prosperity and purchasing power must necessarily go hand in hand, it might do a great deal more harm than good.* It was necessary, therefore, to be careful.

The italics are mine, but the conception outlined in them is very significant. It will also be seen in Section 5 above mentioned that Mr. Clegg states that 'whilst for a country like England, which lays itself open to large and sudden demands for gold, a less elastic system is better.' But why should England lay

itself open to large and sudden demands for gold, and thus make it necessary for the producers of Great Britain to have a less elastic system than the United States, France, or South Africa? It must surely be due to the free trade system which she maintains, in which imports always largely exceed exports. This pointed remark by Mr. Clegg is very significant, and, intuitively, he lays his finger on the weak spot of the whole system.

The fact that England has to carry the largest war debt in the world, and the heaviest burden of taxation, must surely indicate that she requires a quickly expanding system, such as is now in operation in the United States, France, and South Africa, and not the inelastic system at present maintained. As Mr. Clegg states later on in his address, 'In England the difficulty of defining a central bank's duties never had to be faced.' 'It has grown from precedent to precedent.' 'In the middle of the last century, Bank of England directors publicly stated that the Bank of England's chief duties were to its stockholders and that its public responsibilities differed from those of other banks in degree only.' I am inclined to think that these same views are still held. This being so, it is surely about time that a new charter was prepared for the Bank of England, clearly defining its public duties in accord with the latest Central Banking practice.

The weak spot pointed to by Mr. Clegg no doubt inspired M. François Marsal, a late French Minister of Finance and a leading banking authority, to write an article in *Actualities*, in reply to Mr. Snowden's assertion that the Bank of France was maintaining its re-discount rate of 3½ per cent. by artificial means, and that actually it was not an effective rate. In this article M. François Marsal stated that 'it would be easy to show the Chancellor of the Exchequer that the French

rate of discount has always been lower than that of other countries, and that its stability has always been remarkable.' He also flatly denied that there was anything artificial in the French re-discount rate, and in support of his contention he mentioned that the French Bank Rate had only been changed twenty-five times in the twenty-five years previous to the War, and that in this same period there had been eighty-four changes in the German re-discount rate, and one hundred and sixty-seven changes in the Bank of England Rate. In dealing with the reasons for the low Bank of France re-discount rate, M. François Marsal said that as there was no threat to the monetary position of France by what was going on abroad, and as France was able to go on importing gold, the maintenance of the French Bank Rate at 3½ per cent. could not be considered artificial. What would have been artificial, however, would have been to increase the French re-discount rate to 6½ per cent. when it was not necessary or essential.

The significant point in M. François Marsal's remarks is that there were 167 changes in the Bank of England re-discount rate in the twenty-five years before the War, whereas there had been only twenty-five changes in the French re-discount rate in the same period. This confirms the view expressed by Mr. Clegg that the Bank of England 'lays itself open to large and sudden demands for gold, and in consequence a less elastic system is better.' It is this inelastic system that has necessitated the Bank Rate being changed 167 times in the years before the War, and that has caused the violent fluctuations in the last year.

France does not maintain a free gold market, yet all through the period of high money rates prevailing in London last year—the Bank Rate went as high as 6½ per cent.—France maintained her re-discount rate of 3½ per cent., at which rate she re-discounted French commercial

bills freely. And the most significant feature was that during the period of high money rates in London, when, according to all orthodox teaching, gold should have flowed from Paris to London, the exact reverse occurred —gold flowed from London to Paris. It thus proves once more that the re-discount rate, in view of the existence of Government debts, has lost its efficacy, and that mechanism alone in future will be able to regulate economic policy.

Further confirmation of the views expressed by M. François Marsal is contained in an article published in *The Economist* of November 9, 1929 (p. 868), and written by its French correspondent, as follows :

The general situation, however, still remains favourable. The Bank of France discount rate remains at 3½ per cent., and there is no apparent likelihood of any modification. Day-to-day money was obtainable in abundance for end-of-the-month purposes at 3 per cent., and the Parquet rate for carrying over was 2 per cent. During the past few days, however, an appreciable change has come over the situation. The plethora of available cash due to the inflow of balances no longer employable in New York has been appreciably reduced in meeting settlement requirements and other commitments, and there is now a feeling of appreciable tightness.

The most curious feature of the present situation, perhaps, is that while there is a constant complaint of shortage of available cash, the amount of money awaiting investment is extraordinarily large. This was amply confirmed by the result of the new Crédit Foncier Loan of frs. 500,000,000 in 5 per cent. bonds of frs. 1,000 offered at frs. 995 (the money being required for financing merchant shipbuilding under Government auspices). The lists were opened on Monday morning, and closed within two hours, the whole issue having been absorbed.

Complaints of 'the sterilisation of credits' by the Treasury continue. Last week's Bank of France statement showed that the Treasury's balance at the bank still totals frs. 6,570,880,000, and that of the Caisse d'Amortissement frs. 6,495,000,000. The restoration to circulation of a large amount of the surplus money in the hands of the latter institution is about to begin, in pursuance of the programme for the reduction by reimbursement of

some frs. 3,000,000,000 of Defence Bonds between now and December 31. What action is to be taken in regard to the Treasury's swollen bank balance and its mass of foreign securities (estimated at anything between frs. 8,000,000,000 and frs. 10,000,000,000) however is unknown; but it is suggested that it may be found possible to utilise a substantial portion of the accumulation in satisfaction of the demand for taxation reduction which is now being pressed upon the Finance Minister.

In the issue of November 30, 1929 (p. 1020), the correspondent of *The Economist* again writes as follows:

The total amount of the floating debt, which now consists entirely of two-year National Defence Bonds, and which amounted to frs. 48,168,000,000 on October 1, 1926, when it was taken over by the Caisse d'Amortissement, had been reduced by July 31 to frs. 31,527,000,000, and will fall by December 31, according to present plans, to frs. 28,200,000,000.

The urgent need for additional capital by even the soundest companies, owing to the stabilisation of the franc at its new level, is eloquently shown by the offers put forward in October which reached a new high record total of frs. 2,293,000,000 (against frs. 1,543,300,000 in July last, the previous high record; frs. 1,525,500,000 in October 1928; frs. 618,000,000 in 1927 (whole year); frs. 400,500,000 in 1926; and frs. 219,900,000 in 1914). Of the total issued in October, frs. 2,238,000,000 consisted of additional capital required by old companies (of which 1,622,000,000 was in debentures and 616,000,000 in shares), and only frs. 55,000,000 by new concerns. The issuing companies included the Crédit Foncier (to procure funds for financing the new national plan for subsidising merchant shipping construction), the Citroën Motor Car Company, and several of the great electricity and gas companies. The average rate of interest offered was 4·80 per cent., against 5·20 per cent. in September, 5·70 per cent. in March, mean rates of 6·03 in 1928 and 7·15 per cent. in 1927, and from 8·85 per cent. to 10·10 per cent. in 1926.

When we consider the state of the franc in 1926, the present success of French banking policy is remarkable. The economist responsible for the present policy of the Bank of France is recently reported to have said that 'when I had to reform Bank of France policy, two

alternatives were open to me: (1) to adopt a monetary policy that favoured production; and (2) to adopt a policy that would establish a money market. I adopted a policy that favoured production, and automatically I have brought about an era of cheap money, thus favouring the finances of the country; and, in consequence of cheap money, I have automatically established a money market. I have thus attained both objects.' He thereby proved that an extension of production created cheap and sound money, and that the existence of the London money market is a consequence of Britain's former industrial prosperity.

A similar experience has evidently been encountered by the Federal Reserve System. London boasts that it is the money market of the world, but the following extract taken from the *Federal Reserve Bulletin* (October 1929) is very significant:

> Increased purchases of acceptances by the reserve banks in recent weeks coincided with a growth in the total volume of American bankers' acceptances outstanding, which reached $1,200,000,000 on August 31. This volume, as is shown by the chart, is about $250,000,000 larger than on August 31, 1928, and more than $400,000,000 above the level for the corresponding date in 1927. The greater part of this increase *has occurred in dollar acceptances created to finance goods stored in or shipped between foreign countries*, which accounted for a total of $315,000,000 at the end of August this year as compared with $152,000,000 and $72,000,000 on the same date in 1928 and 1927, respectively. There has also been an increase as compared with recent years *in the volume of bills created to finance export and import transactions and to furnish dollar exchange.* Acceptances falling under the latter classification showed the largest relative increase for the year. During previous years the volume of such bills averaged about $25,000,000, but on August 31 of the present year were outstanding in the amount of $63,000,000. The increase in this type of acceptances appears to indicate a growing demand for dollar exchange by such countries, mostly in South America, as are permitted under the provisions of the Federal Reserve Act and the rulings of the Federal Reserve Board to draw acceptances

on American banks for the purpose of obtaining exchange. The chart indicates that the increase in acceptances outstanding started earlier this year than in the two preceding years, and up to the end of August was considerably larger than in those years. *It appears, therefore, that dollar exchange has financed a larger proportion of world trade this year than in other recent years, with the consequence that foreign money markets have been relieved of a corresponding demand for credit from this source.*

The italics are mine.

It would seem that the volume of acceptance business done by the Federal Reserve System now exceeds that done by the money market in London.

I wonder what those London bankers, who have hitherto opposed Central Banking practice, have to say in reply to this fact? Will they still assert that if Great Britain adopted Central Banking practice and safeguarding, the London financial market would lose the £65,000,000 which it derives from its commissions and discounts? This would go on to a large extent in any event, and the question as to whether this sum helps to make good our adverse balance of trade has no relevancy to the problem which we are setting ourselves to solve, namely, How best to increase the wealth productive power of the country, and secure a more equitable distribution of the wealth when it is produced.

It is to be observed that the mere increase in the U.S.A. member bank deposits in the last nine years alone exceeds the grand total of the British and Irish joint stock bank deposits as at December 31, 1928.[1] If we examine the respective price levels we shall find that not only is the British price level[2] at the lowest

[1]

Great Britain and Ireland.	U.S.A.	Per Cent. British to U.S.A.
Deposits of all Joint Stock Banks.	*Deposits of Member Banks only.*	
Dec. 31, 1914, £1,135,440,000	Dec. 31, 1914, £1,718,500,000	66·0
„ 1919, £2,356,000,000	„ 1919, £5,386,000,000	43·7
„ 1928, £2,409,500,000	„ 1928, £8,056,600,000	29·9

[2] See table on p. 106.

GREAT BRITAIN

WHOLESALE PRICES (BOARD OF TRADE), 1913 = 100.

—	1919.	1920.	1921.	1922.	1923.	1924.	1925.	1926.	1927.	1928.	1929.
June . . .	238	322·4[1]	197·7	159·3	159·3	162·6	157·2	146·9	142·1	142·6	135·4
December . .	297	264	168	155·8	163·4	170·1	153·2	146·1	140·4	138·3	132·5
COST OF LIVING (MINISTRY OF LABOUR), JULY 1914 = 100.											
June. . .	205	250	219	180	169	169	172	169	163	165	161
December . .	225	269	199	180	177	181	177	179	169	167	166

UNITED STATES

WHOLESALE PRICES (DEPARTMENT OF LABOUR STATISTICS), 1913 = 100.											
June. . .	194	238	134	138	144	136	148	144	134	140	138
December . .	216	173	132	144	140	145	148	140	139	138	135
COST OF LIVING (DEPARTMENT OF LABOUR STATISTICS), 1913 = 100.											
June . . .	177·3	216·5	180·4	166·6	169·7	169·1	173·5	174·8	173·4	170·0	170·0
December . .	199·3	200·4	174·3	169·5	173·2	172·5	177·9	177·6	172·0	171·0	—

[1] From 1920 New Index.

point in the present movement, but so also is the American.[1] There can be a slump of prices from a high price level, but, if the mechanism of the monetary system be sound, there can never be a slump from a low one, and this would seem to have been the experience of the Federal Reserve System in recent months. There is no apparent reason, therefore, why the recovery of the prosperity of the U.S.A. should not continue to increase.

I am not here concerned with the excessive speculation that took place in the stock and real estate markets in the U.S.A., the continued expansion of which was evidently based on her industrial prosperity. The two movements were, and are, separate and distinct. It is clear that speculation will disturb any monetary system however sound. But no irregularity of this kind should prevent the adoption of a system that will bring about the greatest industrial activity, employment, prosperity and welfare. As Adam Smith so truly stated, 'Consumption

[1] U.S.A.

INDUSTRIAL PRODUCTION
(*Federal Reserve Bulletin.*)

Index numbers, adjusted for seasonal variations. As revised in February 1929. 1923–5 average = 100.

INDEX OF INDUSTRIAL PRODUCTION

Month.	Total.							
	1923.	1924.	1925.	1926.	1927.	1928.	1929.	1930.
January . .	100	100	106	107	107	105	117	103
April . .	107	95	103	108	109	109	122	—
July . .	104	84	104	108	106	110	124	—
October . .	99	95	105	111	103	114	117	—
Annual Index	101	95	104	108	106	110	—	—

is the sole end and purpose of all production ; and the interest of the producer ought to be attended to [1] only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident, that it would be absurd to attempt to prove it.'

In advocating the adoption of modern Central Banking practice by the Bank of England, I do not thereby seek for an inflation of the currency ; but I do urge that the Government Securities held against the Fiduciary Issue of £260,000,000 should be gradually reduced to a sum not exceeding £25,000,000 ; that the securities sold should be replaced by fine commercial bills of exchange ; and that all further expansions of currency should be made on similar cover, in addition to gold—but without any fixed ratio between gold and bills—so as to enable the principle of convertibility into gold bullion on demand being more easily maintained than it is at present, without the need for a high Bank Rate, and the frequent changes that take place in the rate. I also seek that the movements of gold shall cease to control the internal credit position and the general level of prices.

The policy I am advocating does not vary in principle from the main conclusions of the Royal Commission on Indian Currency and Finance (1926), of which Sir Hilton Young was chairman, and Sir Henry Strakosch a member. The Report issued by this Commission is one of the best I have read on currency questions. The following quotations from this Report not only confirm my general thesis, but they are highly significant :

Paragraph 96. The Reserve Bank's principal function being to re-discount bankable bills held by the commercial banks, it is desirable that the Boards of the Reserve Bank should exercise their unfettered discretion in accepting or rejecting such paper, and it is therefore undesirable that representatives of any of the commercial

[1] And, I would add, the banker.—J. T. P.

banks should hold the position of President, Vice-President, or member of a Local Board or that of member of the Central Board. A provision to this effect should be embodied in the charter.

Paragraph 116. It is evident that a limitation of the monetary circulation to the real needs of the country postulates contraction and expansion of the currency in accordance with those needs. In a mainly agricultural country like India those needs fluctuate widely, not merely according to the seasons of the year, but also according to the abundance or otherwise of crops and the prices they command. If that part at any rate of the notes which the Bank issues to meet the need of expansion is secured by assets of a character corresponding to this need of expansion, that is, if these assets mature and are liquidated when the increased monetary circulation is no longer needed, the process of expansion and contraction becomes almost automatic. The true commercial bill, that is a bill drawn in respect of a genuine commercial transaction, has these characteristics in a pre-eminent degree. It is a self-liquidating asset in the sense that the liquidation of the commercial transaction liquidates the bill.

Paragraph 117. While internal stability is a fundamental condition to assure the external stability of the rupee, it is nevertheless essential that the note issue should be secured to a substantial extent by assets which are capable of rectifying a temporary disequilibrium in the foreign balance of payments. Disequilibria are bound to occur, sometimes for seasonal causes, and sometimes for reasons of a bad harvest or financial stringency internally or externally. Gold and gold securities are the assets most suitable for this purpose, for they can be readily employed to discharge external liabilities, pending the adjustment of the disequilibrium through an appropriate credit policy by the Bank.

Paragraph 126. There is first what may briefly be termed the fixed fiduciary issue system, which has been adopted by England under its Bank Charter Act of 1844. By this Act the Bank of England is authorised to issue its own notes on the security of Government debt to an amount fixed by statute. Any additional notes over and above this fixed fiduciary limit have to be secured by a gold backing of 100 per cent. The system rests on the thoroughly sound doctrine that there is a minimum of currency which must always remain in circulation unless the mechanism of exchange is to break down completely, and that, so long as the fiduciary issue is well within that minimum, there is no danger of the purchasing power of the currency being adversely affected.

Paragraph 128. It will be appreciated that, under this system, expansion or contraction of the note issue beyond the fixed fiduciary limit takes place at a rate exactly corresponding to the increase or decrease of the gold reserves. The system is a cautious one, but safety is secured at the expense of elasticity. In spite of its rigidity, however, the system has worked well in England, not because expansion and contraction are not as necessary there as they are in other countries, but because the widespread development of the joint stock banking organisation of the country has led to the cheque, and not the bank note, being the chief medium of exchange. Expansion and contraction of the currency in England thus takes place through the cheque currency, and so imparts to the system the necessary elasticity.[1]

Paragraph 130. The Federal Reserve System possesses the quality of elasticity to a far greater extent than the fixed fiduciary system. The objection is sometimes raised that, because of this greater elasticity, it lends itself to inflation, and is therefore less to be recommended than the fixed fiduciary issue system. It may, on the other hand, be said that, as the fixed fiduciary issue system can only work satisfactorily where the chief medium of payment is not the note but the cheque, the scope for inflation through an undue expansion of credit is just as great as it is in the case of the proportional reserve system, with legal tender money as the chief medium of exchange. *Both systems obviously require prudence in the management of currency and credit.*

Paragraph 136. Dealing with the question of the propriety of including Government of India securities among the reserves, *it is easy to appreciate that they form a far less desirable asset than commercial bills*, for they lack that most useful quality of the latter to expand and contract the currency automatically in accordance with the needs of the country. In the case of Government securities, expansion and contraction depends entirely upon the will and judgment of the currency authority, and is therefore more liable

[1] I do not agree with the opinion expressed in the latter part of this paragraph. The present cheque system referred to merely transfers credit from one account to another. Credit is transferable by cheque, and to compare it with currency is foolish. We may convert credit into currency, and currency into credit, but that is different from saying that credit is currency. Furthermore, the present cheque system deals more with financial credits than with commercial credits, and ignores the use of money, so that the analogy is ill-chosen. Under the Federal Reserve System, eligible commercial credits are financed by currency, whilst financial credits are financed by member bank credit. There is no comparison between the two systems.

to errors of judgment. A large holding of Government securities, moreover, might give rise to difficulties in connection with their realisation if the need arose. Their inclusion among the reserve assets of the Issue Department can therefore only be justified if the amount held is limited to only so much of the circulation as is unlikely, in any circumstances, to be withdrawn, plus such further amount as can in all probability be realised without causing an undue disturbance of the Government's credit.

The italics are mine.

NOTES TO CHAPTER XIII

Under the Bank of England system the cover for any increase in the note issue must be gold. The authorised issue at present (March 5, 1930) is £411,601,773, of which £151,601,773 is covered by gold which equals 37 per cent., and £260,000,000 is the fiduciary issue which equals 63 per cent. This method of covering the notes issued enables the Bank of England to maintain an inelastic system. By holding Government debt as cover instead of fine commercial bills, the Bank is able to allow an import or export of gold to take place without affecting its holding of Government Securities against the fiduciary issue.

In other words, an export of £4,000,000 of gold would cancel £4,000,000 of the currency in circulation. An import of gold would increase it by a like amount. Under the Federal, or South African, ratio systems an export of £4,000,000 of gold would cancel £10,000,000 of currency, *i.e.* £4,000,000 in gold and £6,000,000 in fine commercial bills, but an import of £4,000,000 would allow the currency to be increased by £10,000,000. Provided there is a tendency for the costs level to tend to fall, the latter system is by far the best for an industrial country like Britain.

Quite apart from its inelasticity, it is very much open to question whether the practice of the Bank, in holding Government Securities as cover to the extent of 63 per cent. of the notes issued—which constitute the basis of the quantity of money—is sound from an industrial, and therefore national, point of view. It seems to me to tend to make industrial turnover static, instead of active.

Under the Federal Reserve System every Federal Reserve Bank must hold:

(*a*) Not less than 40 per cent. in gold against notes in circulation.

(*b*) Not less than 35 per cent. in gold or lawful money against deposits which consist mainly of balances of 'Member Banks.'

In actual practice, at the present time, the reserves held against Federal Reserve notes are 92 per cent., and against deposits 53 per cent. These high reserves are maintained in order to neutralise part of the imports of gold into the U.S.A. in recent years, but for effective purposes they are unnecessary. The gold held in excess of legal requirements is, in fact, immobilised, and the surplus could very well be distributed among the nations of the world, where it would render a far greater service, not only to the American people, but to humanity at large.

Under the Federal Reserve System the cover against issues of Federal Reserve notes has to consist of at least 40 per cent. gold

and the remaining 60 per cent. eligible collateral security which is carefully defined in Section 13 (2, 3, 4, 5). This collateral is to consist of notes and bills accepted for re-discount under the provisions of Section 13 of the Act.

The Regulations of the Federal Reserve Board define the character of a note, draft, or bill of exchange, eligible for re-discount at a Reserve Bank, *inter alia*, as follows :—

(*a*) It must be a negotiable note, draft, or bill of exchange, which has been issued or drawn, or the proceeds of which have been used or are to be used in the first instance, in producing, purchasing, carrying, or marketing goods in one or more of the steps of the process of production, manufacture or distribution. (When used in this Regulation the word 'goods' shall be construed to include goods, wares, merchandise or agricultural products, including live stock.)

(*b*) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings or machinery.

(*c*) It must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace; but if drawn or issued for agricultural purposes or based on live stock, it may have a maturity at the time of discount of not more than nine months, exclusive of days of grace.

(*d*) It must not be issued for carrying or trading in stocks, bonds or other investment securities, except bonds and notes of the Government of the United States.

(*e*) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for investments of a purely speculative character.

(*f*) It may be secured by the pledge of goods or collateral, provided it is otherwise eligible.

The Federal Reserve Bank may also re-discount acceptances based on the import or export of goods, or those created for the purpose of furnishing dollar exchanges, provided they bear the endorsement of at least one member bank.

If a person borrows money from a member bank in order to lend it to other people, then the member bank is not permitted to re-discount this paper with a Federal Reserve Bank.

The only paper excepted from this rule is that issued by factors who borrow money from the banks for the purpose of lending it to producers of agricultural staples (Agricultural Credits Act, 1923), and that issued by co-operative marketing associations, the proceeds of which are to be used to lend to members of the association for their productive agricultural operations.

The total currency in circulation in the U.S.A. on December 31, 1929, was $4,912,015,000, divided as follows:

		Gold Cover.
	$	$
Gold coin	383,742,000	383,742,000
Gold certificates . . .	879,563,000	879,563,000
Standard silver dollars . .	42,184,000	—
Silver certificates . . .	416,874,000	—
Treasury notes of 1890 .	1,273,000	—
Subsidiary silver . . .	293,804,000	—
Minor coin	119,461,000	—
United States notes . .	264,878,000	159,039,088
Federal Reserve notes . .	1,909,723,000	1,750,205,000
Federal Reserve Bank notes .	3,413,000	(*a*)
National Bank notes . .	597,100,000	—
	4,912,015,000	

(*a*) Lawful money has been deposited with the Treasury for the retirement of these notes.

From the above table it will be seen that Federal Reserve notes are now the predominant form of currency in the U.S.A. These notes are obligations of the U.S.A., and are a first lien on all the assets of the issuing Federal Reserve Bank. National Bank notes are secured by U.S. bonds except where lawful money has been deposited with the Treasurer of the U.S. for their retirement. A 5 per cent. fund is also maintained in lawful money with the Treasurer of the U.S. for their redemption. Before the Federal Reserve Act, National Bank notes and gold and silver coins, along with the greenback Government note issue and State Bank notes, were the main form of currency. No gold had to be held against National Bank notes. This is still so, and these are still in circulation in diminished volume, and they form a far smaller proportion of the total currency in circulation now than in 1913. Large volumes of gold and silver certificates were in circulation in 1913, as they are at present.

It will be seen that the total currency in circulation in the U.S.A. is varied and complex, and that, consequently, there is still considerable room for improvement. It would make for greater efficiency if all the various currency issues were brought under the direct control of the Federal Reserve System, and if they were to be substituted by Federal Reserve notes.

CHAPTER XIV

THE GOLD RESERVES AND THE FOREIGN EXCHANGES

As the bill of exchange is the only instrument that can expand credit and currency on a safe and secure basis, then it follows that the gold reserves could be freed to be used exclusively for convertibility purposes, *i.e.* for the settlement of any adverse balance of trade. Under the ' Dual System of Stabilisation,' the competitive power of the exporting trades in the world markets would be increased, and the increased foreign credits thus established would eventually come under the control of the London money market, and thus prevent, or diminish, any serious drain on the gold reserves held by the Bank of England. As indicated elsewhere (p. 28), this ' Power of Disposition ' should form a part of British Central Banking mechanism, and if it were made so, the pound could be maintained at parity in the foreign exchange markets with greater ease and facility, and at considerably less expense, than is being done at present.

The par of exchange should be the face value of the currency unit of one country, expressed in terms of the currency of another country, which uses gold bullion for convertibility purposes, and this definition holds good even now. The value of a national currency unit is taken to depend on the quantity of purchasing power which it commands—at the general level of world prices—over the mass of home-produced commodities, including gold bullion, for which latter purpose adequate gold reserves should be held. The par of exchange should

accordingly tell us how much we are entitled to receive in commodities and/or gold bullion from other countries in exchange for their currency. In so far as the international exchanges go, therefore, the mint par of exchange should, in future, simply mean that the holders of a national currency will have the right of converting its face value into gold bullion at a given weight and fineness, established by the law of that country, in the event of any depreciation having taken place in its internal purchasing power value.

Under the Act to facilitate the return of a gold standard and for purposes connected therewith (May 13, 1925), it is provided that 'the Bank of England shall be bound to sell to any person who makes a demand in that behalf . . . gold of the standard of fineness prescribed . . . but only in the form of bars containing approximately 400 oz. troy of fine gold.' The value of a bar of standard gold of this weight is equal to £1,556 13*s*. 4*d*.

The remaining questions to be solved, in so far as they apply to the gold reserves, are as follows :

(*a*) Should a definite maximum limit be placed on the gold reserves to be held by the Bank of England ? If it be agreed that it would be unnecessary under modern Central Banking practice to maintain a fixed ratio of 40 per cent. gold to 60 per cent. of bills, then, for all practical purposes, the Bank need not increase its gold reserves beyond £175,000,000.

(*b*) If (*a*) is decided in the affirmative, should the fixed price for the purchase and sale of gold be maintained ?

(*c*) Should the overdraft be abolished, and the bill of exchange substituted therefor in acknowledgment of all the advances made by the joint stock banks ? And should such bills of exchange be classified into grades (*a*), (*b*), (*c*) and (*d*), etc., and the amount in each grade reported to the Central Bank weekly, or monthly, as the case may be, with a view to controlling an excess of speculation ?

Although the questions raised are ones for the Committee on Industry and Finance to determine, I should like to make an observation in view of what I have previously written. If item (*a*) should be decided in the affirmative, the Bank of England may find it possible to limit its reserves at £175,000,000 without abandoning the fixed price established for the purchase and sale of gold. In view of the shortage of gold for monetary purposes, and if other European and Eastern nations could be induced to adopt modern Central Banking practice, and be assisted in this work by the first-class Powers, then there would be little possibility of gold ever becoming surplus to requirements for monetary purposes. Furthermore, with the increased general world prosperity that would ensue, there would be a greater general demand for gold for manufacturing purposes, so that a fixed price might be easily maintained for the purchase and sale of gold, even although the Bank of England was not a buyer.

It may ultimately be found necessary to allow the price of gold to find its own market level. Even then I can see no harm in this, so long as inflation and deflation can be eliminated from the industrial system. The sole object of fixing a price for the purchase and sale of gold is simply to eliminate the law of supply and demand from the marketing of gold, but with the 'Dual System of Stabilisation' in force, and as the inflation and deflation of prices would, under that system, be eliminated from the industrial system, it may be found unnecessary to maintain a fixed price for the purchase and sale of gold. I merely express this view for future guidance.

CHAPTER XV

THE MARGIN OF LENDING POWER

A VERY important factor to be considered in a study of the science of money is the margin of lending power possessed by the banks. This margin should not be determined by the economic circumstances of the moment, since the sufficiency or insufficiency of the margin to cope with the country's obligations or requirements, and the degree of elasticity in the currency, will determine the economic circumstances of the moment.

The basis of all national activity is confidence and enterprise—confidence in the fact that the distribution of economic justice will proceed fairly without restriction, since confidence is not only the basis of credit but of enterprise. Until confidence is established, the spirit of enterprise cannot have full play. The conceptions of to-day are the realities of to-morrow, and men will not build castles in the air, so to speak, unless they feel confident they have a fair chance of realising them.

Bankers have by experience established what they consider to be a safe limit for their ratio of cash to deposits and advances. To-day the ratio of cash to deposits is 10·4, and beyond this the bankers cannot go. As the bankers have reached their safety limit, how do they propose to cope with the considerable increase of trade activity that is envisaged, and that is necessary to maintain the country in a solvent condition? The margin of their lending power beyond the ratio of 10·4 is extremely limited. It is indeed fractional, and because this fractional margin exists some bankers and

economists are of the opinion that there is no evidence of a shortage of lending power. So long as there is an apparent sufficiency for current demand, there is apparently no evidence of a shortage of lending power. But what they fail to realise is that current demand can only be stimulated by an elastic currency system, and that an acceleration of consumption is a pre-requisite condition to an acceleration of production.

Those who advocate the imposition of import duties with a view to promoting trade activity little realise that without a change in monetary policy their hopes will not be realised. The pressure on the gold reserves cannot be lifted without import duties, but it is clear that the latter cannot be imposed without a change in the mechanism of the monetary system.

The margin of lending power should not be static. It should be elastic, and should rise and fall with the country's obligations and requirements. This is all the more essential in the case of Great Britain, which is the central pivot of the British Empire, and towards which she has certain economic, financial and moral responsibilities.

No reform of the monetary system is possible without the full consent and approval of the bankers. Confidence will always be the basis of credit, whatever monetary system is in being. But if a change in the mechanism of the monetary system can be effected without impairing any of the sound principles for which bankers stand, and if such a change will get rid of all our social disorders, can any valid objection be raised against making the change?

Modern Central Banking is the greatest sociological instrument yet devised for the advancement of the welfare of mankind, particularly a system that can efficiently and effectively economise in the use of gold. This I claim the 'Dual System of Stabilisation' will do. It is a

system that aims at eliminating inflation and deflation from the monetary system, and, for this reason, should appeal to bankers generally.

Bankers are as patriotic as any other section of the community ; they are also just as anxious as most other people to bring about a more equitable distribution of wealth which alone can contribute to the welfare and prosperity of mankind. But they desire to be shown that any suggested changes in the mechanism of the monetary system do not conflict with the sound principles for which they stand, and which have stood the test of experience. This is a natural reservation. If, on the other hand, bankers could but realise that the only mechanism through which we can get rid of the social and economic difficulties which afflict the world to-day is modern Central Banking, they would gladly, I think, apply their minds to a study of the question. It is in this spirit, I hope, that bankers and economists will approach the question. I would like them to bear in mind that wealth is income and not capital. The wealth we produce in the current year is income ; all else is capital. What we save out of our income is liquid capital. Therefore the more we can produce the more we can divide. But we cannot divide until we produce, and the only effective instrument through which we can equitably distribute wealth is through money. It is better by far to extend production than to extend taxation, and without the assistance of bankers we cannot attain this most desirable objective. The bankers alone can initiate, on strict practical terms, the greatest social reform of the age. It is to my mind a great responsibility which rests on their shoulders, and one that should not lightly be disregarded.

CHAPTER XVI

FREE TRADE AND PROTECTION

I AM no advocate of Safeguarding whilst present monetary policy is pursued. If it is true to say that the fall in the general level of prices throughout the world is due to a shortage of gold for monetary purposes, or to its unequal distribution, then Safeguarding and Empire Preference cannot, by any stretch of imagination, arrest the fall in the general level of world prices. On the contrary, the introduction of Safeguarding, without an alteration of monetary policy, would permanently injure the export trades, which would still have to compete at the world price level. Safeguarding cannot do other than raise costs of production in the exporting industries, without any compensating advantage. It may, of course, benefit those industries who do little, if any, export trade.

Free Trade is not a science. It is merely an implication of the quantity theory of money, which rules that if the quantity of money remains the same, and the volume of production is increased, prices and wages must fall ; and this is precisely what is happening to-day. In other words, people must accustom themselves to low prices and low wages if they desire the quantity of money based on gold to do the maximum work possible. But it should be noted that although prices are on a low basis, costs of production are on a high level, owing to taxation and arbitrary limitations on wages and production. Therefore, Free Trade is a policy in which prices are controlled by the monetary system, irrespective of costs,

and not by the producers. It is thus an implication of the 'quantity theory.'

Likewise, the quantity theory of money based on gold rules out Safeguarding, *per se*, as a cure for our present industrial depression. If the quantity of money is fixed, no increase in the quantity of work can take place without a proportionate increase in the quantity of money. Those who support Safeguarding without recognising this scientific fact are doing the country and its future a great deal of harm.

Free Traders are right when they say that industries which benefit from Safeguarding, whilst the present monetary system is maintained, must do so at the expense of other industries not so protected. They are right because the quantity of credit that can be anchored to gold is a fixed quantity. Thus any increase of production which requires an increase of credit, and cash for wages, is not possible, unless the industries so benefited do so at the expense of other industries. On the other hand, the producers are scientifically correct when they say that, if they were able to increase the volume of work, they would be able not only to pay high wages, or higher wages than are possible under Free Trade, but to decrease the cost of production per unit of goods produced. This is the basis of the 'Dual System of Stabilisation.'

The productive industries are quite prepared to increase output and purchasing power so long as they can earn a reasonable profit on their capital in the process—*i.e.* it makes no difference to them what the volume of goods may be that machine power can deliver to their customers in exchange for their money—and through them to the consumers—so long as the consumers have the purchasing power with which to buy, and the producers are able to earn reasonable profits on their capital in the process. Thus the economic controversy

on the relative merits of Free Trade and Protection is removed to one of monetary policy. If we had a satisfactory monetary policy, producers would be able to produce and sell manufactured goods more cheaply than the consumers could buy abroad—and still pay higher wages than are possible at present. In view of this, there would be no object in maintaining the Free Trade system, since the producers would be able to defeat its only virtue, namely, cheapness.[1]

Owing to the law of diminishing returns, the foregoing argument does not apply so much to agriculture, but this will not matter, since all true purchasing power originates with the soil. As a balance has to be maintained between agriculture and industry, the cost of the food required by the population is the sheet-anchor of purchasing power, *i.e.* its balancing factor.

Where, then, is the flaw? It is to be found in the fact that the quantity of money cannot be increased proportionately with the volume of work that could be done within the country, and which is so essential if the diseases of inflation and deflation are to be automatically removed from the whole industrial system, and if the basic industries are to recover their prosperity on a permanent basis.

As the quantity of money is regulated by its gold base —or its theoretical gold base—then, if distribution is to be increased in order that all of the people may get some justice from the economic system, the limited quantity of money available for production must do as much work as possible. Free Traders contend that this is best achieved by buying in the cheapest markets and selling in the dearest. The pursuit of this theory necessitates,

[1] Although it may be necessary for us to accept imports in discharge of interest receivable on our foreign investments, it is not necessary to expose the whole of our productive power to the competition of duty-free imports. I deal with this aspect of the question more fully in Chapter XXII.

however, the maintenance of low wages and a high degree of poverty.

Another point in favour of Free Trade is as follows : a very large part of the foreign trade of Great Britain is transacted by foreign banks, and the presence of £200,000,000 of foreign balances in the City of London is a confirmation of this. If Free Trade were to be wholly shut off we should lose the advantage of these credit resources, which the country at present, *i.e.* under the existing system, cannot afford to lose. This aspect of the question has not been fully appreciated.

The tribute payable by Great Britain to foreign banks by way of interest charges on the foreign balances alone is about £10,000,000 per annum, and to this has to be added the commissions and charges payable on the financing of part of our imports and exports.

But under the new economic system proposed, it is provided that the total trade of the country will be carried on the nation's own credit resources, and at cheaper interest rates than now prevail. Thus the usurious rates now paid for the use of foreign short money, and the charges paid for financing its trade, will be saved to the country.

The final question that has now to be asked in more technical terms is this : Why are both Free Traders and Safeguarders correct within their own line of argument ? Is the separation not caused by the necessity of maintaining price and value as two separate factors within an exclusive gold basis monetary system ? and if price and value could be made to mean one and the same thing, would it bring about a general agreement between Free Traders and Safeguarders ?

CHAPTER XVII

PRICE AND VALUE

PRICE to-day is dictated by money, and the amount it can afford to pay is determined by its quantity. (This is a recapitulation of the quantity theory of money. Increase the quantity, prices rise ; decrease the quantity, prices fall.) Value is created by the producers, and the lowest price at which they can afford to sell without incurring a loss is their cost of production. But as costs of production include the weight of taxation, the producer is entitled to recover these in the value of the goods he produces. We have seen, however, that the larger the output of the producer, the lower is the cost of production per unit of goods produced. Thus the service which science and production—and science and production alone—can render to humanity is to destroy values, *i.e.* it aims at lowering the price value of all commodities, subject to profit. Therefore, when money is the counterpart of production, *i.e.* when it increases proportionately with the volume of production, price and value will mean one and the same thing (*i.e.* = price-value).

Under modern Central Banking practice, price should be a numerical expression only, and should indicate the worth in pounds, shillings or pence of a commodity to be bought or sold. Price should function as an indicator only, *i.e.* it should indicate the price-value of the commodity to be bought or sold. This will be its normal function when the pound is secured on the mass of

commodities and not on the theoretical gold basis it is at present.

In other words, the producers should have the right to pre-determine the price-values of their own productions. At present, money pre-determines the price it can afford to pay. If it diminishes in quantity, the price will be less ; if it increases in quantity, the price will be more. A little reflection will indicate that this function of pre-determining prices is one which the producers alone should assume, since it also involves wages.

PART II

CHAPTER XVIII

THE DUAL SYSTEM OF STABILISATION

Inflation

INFLATION can be produced in two ways :

(1) By an increase of paper currency not backed by wealth products. This creates a demand for goods that do not exist.

(2) By an increase in the price of commodities brought about by speculation in natural materials and foodstuffs, which is facilitated by the method of credit expansion employed in a gold basis system.

The orthodox economists hold that prosperity is only possible in a period of rising prices, and within a gold standard system this is true. Rising prices may originate a short-lived boom ; but, as they soon reduce sales, they ultimately compel a restriction of credit which injures both the producers and consumers. Steady trade any an era of gradually falling prices subject to profit are more advantageous. A greater and more permanent prosperity can be obtained without inflation, and without raising prices.

The disadvantage which ensues from a rise in the price level is an increase in the 'cost of living.' It burdens the school teachers, doctors, men of science, judges, civil servants, professional men, clerks, pensioners, salaried workers and wage earners. Discontent pervades many classes. Colleges, churches, hospitals,

and other endowed institutions suffer through a rise in prices, which increases their expenditure whilst their income remains the same. Savings bank depositors, holders of Government and other trustee securities, of mortgages and life insurance policies, of industrial debentures, and of fixed investments of any kind find that, as the price level rises, the purchasing power value of their securities melts away. £100,000 lent to-day may be worth only £70,000 in ten years' time, through no fault of the lender. A £2 weekly wage to-day may be worth only 35*s.* in terms of purchasing power in a year's time. A reform of the monetary system can eliminate these defects from the economic system.

Deflation

Deflation is brought about by a restriction of the volume of credit, and of purchasing power; hence it is the cause of business depression, diminished production, and unemployment. Every person unemployed is a potential customer out of work. Consumers who are able to buy will only do so sparingly when prices are forced to fall through a restriction of credit based on gold. Consequently, factories shut down for lack of orders, and unemployment grows. The bins at the factories and warehouses may be full of merchandise that can be offered at cheap prices, but they cannot be consumed in sufficient quantity because the public lack the requisite purchasing power.

Deflation benefits the creditor and harms the debtor, since it increases the burden of debt. In periods of deflation, therefore, manufacturers find it difficult to meet their obligations, farmers find it difficult to pay the mortgages on their land, or the interest charges thereon. Many are thrown into bankruptcy, and economic progress is brought to a standstill. The suffering and distress which follow engender class hatred and political turmoil.

An example of the way in which deflation benefits

creditors—in this case brought about by the return to the gold standard—may be seen from the present position of the national debt as compared with the earlier years :

Year.	Amount of National Debt (Millions).	Applied to Debt Reduction (Millions).	Interest Charges on Debt including accrued Interest N S. Certs. (Millions).	Wholesale Price Index.	Equivalent of Debt on 1928 Gold Basis (Millions).	Equivalent of Interest Charges on 1928 Gold Basis (Millions).
	£	£	£	£	£	£
1919 .	7435	5	277	186	3997	149
1920 .	7829	9	340	225	3479	151
1921 .	7574	256	340	145	5223	234
1922 .	7654	75	316	116	6626	272
1923 .	7742	130	320	116	6700	275
1924 .	7641	93	323	122	6263	264
1925 .	7598	54	323	117	6494	278
1926 .	7559	55	319	109	6935	292
1927 .	7555	23	339	104	7264	326
1928 .	7528	65	312 [1]	102	7380	306 [1]
1929 .	7500 [3]	57	310 [1]	100	7500	310 [1]
		822 [2]				

[1] Excluding accrued interest, National Savings Certificates, not ascertainable.
[2] Although £822,000,000 has been applied to the redemption of debt, 1919–29, yet the nominal debt is still greater than it was in 1919, and the interest charges are approximately the same, after allowing for the annual payment on account of the American debt.
[3] Plus outstanding accrued interest, National Savings Certificates.

As will be seen from the foregoing figures, the purchasing power value of the national debt has, since 1921—which is a fair average year—increased by nearly £2,000,000,000. As the purchasing power value of the debt has increased, the value of agricultural land, factory premises, and plant has decreased in proportion. Also, as approximately 70 per cent. of the national credit resources has to be used to finance the national debt and other trustee securities in order to keep them marketable and liquid, this has diminished the volume of credit available for production. Hence the reason for the fall in commodity prices and wages.

Likewise, as deflation necessitates a contraction of the

currency in circulation, it has brought about a decline in purchasing power.

It has been stated by economists and by the late Chancellors of the Exchequer, that a falling price level, due to deflation, means an increase in purchasing power, but this presupposes that, in the meantime, there has been no diminution in the volume of currency in circulation. If, for example, and as there is every reason to believe, there has been a considerable contraction since 1920 in the volume of currency in circulation, free from the control of the banks, then obviously it cannot be said that purchasing power has increased with the falling price level. The truth of the proposition depends, for any particular class in the community, upon whether the distribution of the purchasing power has remained the same. In other words, whilst it is true to say that the purchasing power of the currency tokens has increased—due to their reduction in amount—it is not true to say that the purchasing power of all the consumers has increased.

The question is important, since there are many more people without bank accounts than there are who have them. Cheapness is, therefore, a relative term, and it can only be determined by the relation which may exist from time to time between the commodities available for purchase and the means of payment that exists within the working community.

The 'Dual System of Stabilisation'

The 'Dual System of Stabilisation' may be defined as a system which provides for the separation of commercial banking from financial banking. This aspect is more fully dealt with in the next chapter. As the commercial system of banking proposed will be exclusively reserved to the industry and trade of the country, and as it will not be restricted or regulated, as in the case of the financial system, this chapter is intended to show in what way

stabilisation can be promoted in commodity prices without artificial control.

The commercial system of banking proposed will eliminate most of the imperfections now to be found within the economic system, of which complaint is justly made. It will permit an era of gradually falling costs of production and rising wages, without any contradiction in the currency or bank cash. As the volume of production expands, the currency and bank cash will be expanded proportionately. Thus we get a dual method of increasing purchasing power, namely, through rising wages and falling prices.

The adoption of the 'Dual System' will eliminate 'inflation' and 'deflation,' two defects that will always be present in any theoretical gold basis system, and if these be removed, what remains will be natural stabilisation. The removal of the diseases of 'inflation' and 'deflation' is essential if steady and orderly national progress is to be attained. I oppose the idea of stabilising the purchasing power of money through the maintenance of a general average of commodity prices, since, apart from its impracticability, it would preclude the dual method of increasing purchasing power through rising wages and falling prices. Furthermore, no provision is made for the control of the inflation of financial values that would be bound to ensue.

Industrialists have hitherto been taught that a falling price level operates to their disadvantage, and is therefore undesirable. This is true under the existing monetary system wherein credit is pyramided on a theoretical gold basis. But as a falling price level under the existing system would be based on deflation, *i.e.* a decrease in the volume of production forced by a contraction of credit, it must necessarily involve the producers in a loss. The falling price level thus produced is controlled by the monetary system, and not by the producers.

But under the commercial system of banking as provided for in the 'Dual System,' a falling price level is at all times under the control of the producers, and is brought about by them at their discretion, through an increase in the quantity of production; so that it cannot be called deflation, since the increase in the quantity of goods produced will have been accompanied by a proportionate increase in the currency or bank cash. Record production, record profits, and high wages can only be obtained through this system. Within it, money is really made the servant of production, and not its master.

The advantages to be derived from the commercial system of banking, as provided for under the 'Dual System,' may be summarised as follows:

(*a*) Prices tend to fall naturally to their lowest point, which is natural stability.

(*b*) As prices tend to fall to their natural stable point, and provided that money is increased proportionately with the quantity of work in accordance with Central Banking practice, the diseases of inflation and deflation are eliminated from the industrial system.

(*c*) If production has been undertaken before credit is expanded, and if credit is expanded on bills of exchange backed by wealth products, both of which conditions are in accordance with modern Central Banking practice, prices will be pre-determined, thus ensuring the removal of the diseases of inflation and deflation from the industrial system.

(*d*) As prices tend to fall, the purchasing power of wages and income increases. In this way, all the benefits that accrue from the improvements in the arts of production are passed on to the consumer.

(*e*) As prices tend to fall, it will be due to a reduction of costs of production. The margin between costs and prices can then be distributed through wages, prices and

dividends. In so far as it is distributed through increasing wages, this also will increase purchasing power and consumption.

(*f*) With the increase of purchasing power and consumption, production is automatically extended.

(*g*) The fact that the producers can increase the volume of manufactures given in exchange for consumers' money, *i.e.* increase the purchasing power of the pound, is one which is immaterial to the producers, provided they are able to obtain a profit on the capital they may employ in production. Production should be regarded as service power, but service power cannot be developed unless profits are earned. The benefits to be derived from the system should be reciprocal.

The 'Dual System' reverses orthodox teaching, which asserts that prosperity is only possible in a period of rising prices. Orthodox teaching also asserts that in view of the present acute depression, a period of falling prices and falling wages will be necessary before we can enter into the period of prosperity which it has taught us to look forward to. There is here no consistency of economic thinking, because it would seem that prices must fall before they can rise. In any event, there is nothing the producers dread more than a period of rising prices engendered by inflation.

The nation's ability to compete in the world markets, and thus to export, is dependent upon the lowest possible cost of production being established within the country; but this is only possible if the nation's productive power is supported, and preferred, by a national monetary system.

Modern production methods entail provision of plant and tools on a scale infinitely greater than anything considered necessary before the War. The justification for locking up capital in plant is eventually the ability to produce at a low cost—which can only be secured by working the plant to a high capacity. This in itself is

only feasible if the purchasing power, and consequently the earning power, of the community is increased proportionately with the volume of production, so that production may be absorbed. In every industry it is the last 25 per cent. of the production that is sold that determines the measure of the profit and loss of the first 75 per cent.

It should be left to potential productive power to reach its own natural point of stability in each sphere of industrial activity. We cannot estimate the extent to which costs of production may be lowered; the potentialities of machine power and chemistry are not yet fully ascertained.

A characteristic feature of the 'Dual System of Stabilisation' is the manner in which it reverses most of the present implications of the Law of Supply and Demand. Owing to the method at present employed in expanding credit, demand must necessarily precede supply which induces prices to rise. Under the 'Dual System of Stabilisation,' supply will precede demand, and thus we make effective the predetermination of prices by producers. If reference be made to the conditions under which eligible paper, *i.e.* bills of exchange, may be rediscounted at Federal Reserve Banks in the U.S.A. (see p. 112), it will be seen that production must precede the expansion of credit; and if the same conditions are rigidly adhered to under any modern Central Banking system that may be recommended for adoption in England, prices will be pre-determined, and thus inflation and deflation will be eliminated. In this way, most of the objectionable implications of the Law of Supply and Demand will be removed.

If producers were allowed to pre-determine prices, it would follow that all produce and merchandise would be listed for sale, and thus the public would know in advance what they would have to pay for what they may

wish to buy. In this way, the implications of the Law of Supply and Demand—as we now understand them—would be neutralised and made innocuous.

Under a barter system of economy, commodities are first brought to market and prices are pre-determined before the currency is called upon to act as the medium of exchange. In other words, their marketability and liquidity are ascertained. Even if prices were pre-determined, however, it would not necessarily follow that all commodities produced would have value, or be entitled to credit. Whilst it is true that the price-value of any wealth product must be based on its cost of production, yet its realisable value (marketability and liquidity) will be determined by its utility, and the potential demand that can be attracted to it. Bankers, therefore, cannot be expected to extend credit on wealth products without these essential qualifications, which are an essential part of the security that will be required under credits 'A.' Costs of production plus the qualifications mentioned will, in fact, constitute the standard of value.

For instance, a banker may be disposed to lend money on Stock Exchange securities if they have a marketable value ; but he would obviously not dream of lending against securities that are unmarketable. Therefore, a similar distinction is certain to arise in the case of all wealth products that may be produced for marketing in a barter system. As I have indicated on more than one occasion, profits are the reward of successful enterprise and loss is the penalty of failure. All enterprise cannot succeed, but all effort is commendable since it is in this way alone that progress is achieved.

The 'Dual System' is opposed to the other form of stabilisation which calls for 'a stable purchasing power,' *i.e.* stabilising a general average of commodity prices. From the producer's point of view, there are several grave objections to 'a stable average price level,' which

will be stated later. The 'Dual System' is a natural system of stabilisation, and the technical points on which information may be sought are as follows :

(1) If the fall in the price of a commodity, which is subject to a potential demand, is met by a proportional increase of consumption only, stability will be maintained since the amount to be spent on the commodity will remain the same. In this case a fall in price will have no direct effect on the prices of other commodities, and therefore no adjustment will be needed. Thus stability will be maintained in other commodities.

(2) If the fall in the price of a commodity, subject to a potential demand, is met by a more than proportional increase of consumption, there will be a transfer of purchasing power usually spent on other commodities to that one. This, however, will be balanced by the increase of labour services employed in satisfying the increased market requirements in this one commodity, which in turn will be balanced by an automatic and more than proportional increase of currency. Both these operations will automatically prevent a fall in the price of all the other commodities which might have occurred owing to the transfer of spending power. Thus the same amount of purchasing power will remain to be spent on the other commodities, and again the 'Dual System' of stability will be effectively maintained.

(3) If the demand for a commodity is a limited one, a fall in its price causes a less than proportional increase in the demand for it. In this case less is spent on it, so that the balance of purchasing power is available for the purchase of other commodities. As this will increase the quantity of production of other commodities, their costs of production will fall ; it would not be possible for their prices to rise. But, in any event, as all prices would be pre-determined, it would be impossible for

this diversion of spending power to cause a rise in prices of all other commodities. The cause and effect would be too limited in scope to be noticed.

(4) A fall in the price of a commodity, subject to profit, will tend generally to lower costs of production in all manufactures, but as costs of production fall it brings within the scope of enterprise the building of constructional work which previously had been considered impossible owing to excessive cost. Thus there will be a continuous demand for labour to complete work, and not, as at present, a continuous demand by labour for work. This conception has to be considered in order to make way for the progressive development of the arts, design, and architecture.

(5) A fall in the price of a commodity, subject to profit, gives to the nation the power of exporting its productions on a price basis that is at least equal to competitive world prices, and thus will enable it to command foreign credits. In other words, it tends to keep industrial competitive power on an efficient basis. In this way the nation can more readily balance its imports with its exports, and the need for holding substantial gold reserves to adjust adverse balances of trade, or to maintain a fixed ratio of 40 per cent. gold to 60 per cent. in bills of exchange, is rendered unnecessary.[1]

(6) If it be admitted that Great Britain cannot produce all the foodstuffs she requires to feed her population, then it is essential for her to acquire the ability to pay for her imports with exports on a price basis that approximates to the general level of world prices. If we fixed the purchasing power of money this would not be possible, and there would be a constant pressure on her gold reserves.

(7) A fall in the price of a commodity, subject to profit, offers to the banker an improved and more liquid

[1] Frederick List aptly describes this law as 'The Power of Disposition.'

security as a basis of credit. It thus ensures an automatic adjustment of credit and money and eliminates 'inflation' and 'deflation.'

(8) As the weight of taxation is largely shifted to costs of production, and has thus to be included in the price-values of all productions offered for sale, it impairs competitive power; and in the event of a forced sale of the manufactures, it induces instability of credit and capital. A lowering of costs of production is desirable in order that the extra margin created may partly absorb the burden of taxation, and thus assist in restoring competitive power at a profit.

. . . . . .

The points against stabilising the purchasing power of money, through the maintenance of a general average of commodity prices, are as follows:

(*a*) The aim of a monetary system should be to distribute economic justice to all sections of the community —producers, consumers, and labour. This is best achieved when it promotes steady trade and employment at a steady profit, and when it maintains a balance between agriculture and manufacturing industry. Within the present system these ideals are not possible, owing to the inevitable inflation and deflation of prices; and it is because of these latter evils that some economists have conceived the idea of stabilising the purchasing power of money and thus ensuring a stable price level. But this conception, I submit, is wrongly conceived, since 'a stable purchasing power' could not ensure stable prices. What would really happen is that money would be given an arbitrary power of fixing artificial values.

(*b*) If the purchasing power of money were stabilised, and our engineers, chemists and scientists were able to lower costs of production and distribute the increased

profit margin by raising wages and lowering prices, it would be necessary—in order to stabilise the purchasing power of money—to increase the volume of the currency, so as to curtail the fall in prices which they could bring about and induce a rise in the price of all other commodities in general, in order to maintain stability. But there could be no economic justice in such an arrangement. Productive power is service power, and should a group of producers render a service to the community by lowering prices, they should not suffer the penalty of paying more for other commodities in general, and so provide increased profits for other producers.

(*c*) Even if the purchasing power of the pound were stabilised by an international arrangement there could be no guarantee that the average price of commodities in all countries could be fixed at a given standard level. Costs of production will be higher in one country than in others, as is the case with Great Britain at the present time. A violent movement of prices could occur within 'a stable purchasing power,' and thus certain commodities may be made dearer in one country than in another.[1] To allow prices to find their own natural level, subject to profit, is the most certain way of eliminating irregularities of this kind. Furthermore, and as we have indicated elsewhere, world stability could best be promoted if nations were to study each other's wants—and so balance, and exchange, their exportable surpluses. Nations should study more closely the principles governing the division and subdivision of labour, so that they may create the exportable surpluses that are likely to be required, either in agriculture or manufactures.

(*d*) To bring about a rise of prices in order to stabilise

[1] If, for instance, prices of agricultural produce were forced to rise, this would increase costs of production generally, and unsettle the balance of trade as between agricultural production and manufactures.

the purchasing power of money is simply a form of inflation ; to make the system effective money must still retain its control over prices ; but we see no reason why money should continue to retain this arbitrary power. Furthermore, it could not reasonably be held that money lent to-day would be worth the same in ten years' time to the lender and borrower. Its value would depend entirely on the prices of the commodities in which they were each interested. Then, again, there is a danger that in stabilising the purchasing power of money there would be a loss of effort and enterprise.

(*e*) By stabilising the purchasing power of money another injustice would be imposed on producers, namely, the present burden of the national debt would be fixed at its present weight, and so would all other debts. At present the burden of taxation is so onerous that the producers must be given an opportunity of dealing with it scientifically, and on the lowest basis of cost. The success of this policy only will cheapen the price of money when trade is most active.

(*f*) Although we might succeed in stabilising the purchasing power of money in commodity values, no provision is made for the inflation of financial values that would be bound to ensue. It would be unfair to control commodity values without controlling financial values.

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An argument put forward against the 'Dual System of Stabilisation' by those who favour 'a stable purchasing power' is that a lowering of prices will benefit debt holders to the disadvantage of the producers, since the latter must sell more of their manufactures to pay their debts. Within an exclusive gold basis system this argument holds good, but within a monetary system based on wealth products it cannot be sustained. A lender should be able to obtain all the economic advan-

tages he could have obtained if he had not lent his money. But he should not receive back less than he lent.

Producers will be able to repay their debts if they are earning profits, and the volume of goods they are able to offer in exchange for consumers' money is immaterial. Everything will be measured by effort, and profit-earning capacity is all that will matter. Furthermore, interest rates on all prior lien industrial securities in the new system will be on a lower scale than they are to-day, but the holders of ordinary shares should be able to obtain a larger and more steady yield than at present —which, of course, would be simple economic justice. It should also be borne in mind that interest rates on Government debt and mortgages would also be on a much lower scale without impairing capital values. Therefore, so long as profits are being earned on the capital employed in production, all debts can be repaid or renewed without disadvantage to the borrower or lender.

The greatest care should be exercised in assuring that productive industry is given every opportunity of extricating itself from the meshes in which it is now entangled, and of gradually liquidating and discharging existing burdens. For this purpose economic freedom is necessary ; and this should not be ignored, whatever the difficulties may appear to be.

CHAPTER XIX

THE DUAL SYSTEM OF STABILISATION (*continued*)

FROM the reviews of the first edition of this book, I gather that I did not define the 'Dual System' as clearly as I might have done. I admit the offence; but I required more time for consideration and investigation.

All previous suggestions in the direction of stabilising purchasing power have been based on controlling a general level of prices, *i.e.* if prices tended to fall, the currency would be expanded in order to bring about a slight inflation with a view to restoring the general level. If prices tended to rise, the currency would be contracted in order to bring about a slight deflation with a view to restoring the general level. This method of stabilising is ill-conceived since it necessitates that the general level of commodity prices must always be controlled by the quantity of money. In other words, we must be prepared to employ inflationary and deflationary methods at times in order to maintain a general average of prices.

One drawback to the foregoing method of stabilisation is that it presupposes the international control of gold, which, if it took place, would result in all nations losing their economic and political independence. The automatic working of the gold exchange standard would also cease. Another defect is that it would bring about economic injustice among the producing classes, since prices might rise in one direction and fall in others. Improvements effected in the arts of production by one section of the producers would be passed on to other

producers and not to consumers. This serious objection cannot be overcome by those who support this form of stabilisation.

The foregoing difficulties are overcome in the 'Dual System of Stabilisation,' which is an automatic system. The 'Dual System' stabilises all the implications of the quantity theory of money which, as I have already shown, is a logical outcome of a currency that is based exclusively on a gold and silver coinage, or on a gold bullion standard. This stabilisation I achieve by dividing the banking system into two sections, (*a*) commercial banking, and (*b*) financial banking. The need for this will be at once apparent when I say that an expansion of currency against eligible bills of exchange will tend to decrease costs of production and prices to their lowest point, whereas an expansion of financial credits will tend to raise security values to their highest point. It is these contrary movements that have caused a great deal of confused thinking in the past on the 'Quantity Theory of Money.'

Under the 'Dual System,' all improvements in the arts of production are passed on to the consuming public and to labour without restriction. Therefore, as the prices of commodities naturally tend to their lowest cost —if speculation is excluded—we have here a natural form of stability. But it is essential that we should prevent all expansions of currency from having any influence upon commodity prices, and this is done by expanding currency proportionately against the volume of eligible bills, which, in turn, are increased or decreased proportionately with the volume of production. We have therefore no need to impose any artificial restriction on the normal working conditions that would prevail in this direction.

Where we need management is in the financial division. As I previously indicated, if we expand currency on

commercial credits we naturally increase the basis on which financial credits can be pyramided, and if no control were exercised here the member banks would have an inordinate supply of financial credit to lend out, and this would be undesirable. This difficulty is overcome by arranging that the Central Bank should control the ratio at which the member banks pyramid their financial credits, the maximum of which I suggest should be fixed in Great Britain at 9 to 1, *i.e.* deposits to cash, until substantial repayments of the National Debt have been made, after which the ratio may be lowered gradually to 7 to 1.

Hitherto, and mainly owing to the system prevailing in England, the Bank of England has always been able to control any inflation of security values and prices by contracting the currency and manipulating the bank rate. These operations are known as ‘ the open market policy.’ But as the Federal Reserve System is mainly concerned with commercial banking only, it is unable to control any inflationary movements in security values, which may take place in the financial markets, by merely manipulating its re-discount rates. It was because of this that the member banks and non-member banks of the American Banking System went on lending money at 10, 15 and 20 per cent. in the recent Stock Exchange boom, which high rates ceased to check the extensive speculation then prevailing.

This confirms my thesis that it is essential that the lending power of the member banks should be controlled by Central Banks so that if speculation in security values gets out of hand, a lowering of the ratios can be gradually effected. This arrangement would avoid the necessity of raising the re-discount rate which, as experience has proved, would have no effect in checking speculation, but which, as it is wholly concerned with commercial transactions, would penalise producers,

traders, and labour unnecessarily, particularly if it were accompanied by a contraction of the currency.

Consideration has already been given to the general effect which an expansion of currency would have within the proposed commercial system of banking. When production increases and costs and prices fall, all that is needed to maintain stability and profit earning capacity is to increase consumption proportionately to the fall in costs and prices. If a more than proportionate increase of production and consumption is brought about in any one commodity, with perhaps a still further lowering of costs and prices in that one, stability will be maintained in other commodities by increasing the quantity of money proportionately, which can be done most effectively and automatically by the Bank of England rediscounting freely all eligible bills of exchange offered for re-discount by the joint stock banks.

The requisite acceleration of consumption is brought about by increasing the volume of currency in circulation free from the control of the banks. The only way by which this may be achieved effectively without causing inflation is against re-discounts. As costs of production fall, producers will be able to distribute the increased margin between costs and prices, through wages, profits and prices. The way to make the world prosperous, to reduce costs and prices to their lowest natural point—which is natural stability—is to increase wages. As we increase wages, so we increase consumption. As we increase consumption, so we increase production. As we increase production, so we reduce the cost per unit produced both in wages and overheads. But this cycle of events can only be maintained if the quantity of money available for production is maintained, or increased, proportionately with production, so that the control of the price level may be transferred away from money to the producers.

When the producers control the prices at which their products are sold, prices are pre-determined, and thus they establish the principle of price-value. When the quantity of money controls the price level, as it does at present under the theoretical gold basis, price and value are maintained as two separate factors, and it is here that inflation and deflation originate. Under the present system, an increase of credit has to originate before production can be increased. In other words, demand precedes supply. Under the new system proposed, supply precedes demand. When demand precedes supply, and if it becomes extensive, inflation ensues, with the result that the purchasing power of the currency is diminished. All inflationary movements are merely the beginning of deflationary movements. Under the present system, when prices are inflated, the people must reduce their consumption of consumable goods. When prices are deflated, they are not able to buy any more of them because deflation implies unemployment, a reduction of wages and profits, and, in many cases, losses. As wages and profits decline, so purchasing power diminishes, and, as a corollary, the currency in circulation free from the control of the banks is contracted. The whole essence of providing adequate re-discount facilities is to ensure a full and free supply of currency notes or bank cash, so as to facilitate the barter system of economy, and so that all improvements effected in the arts of production may be passed on to the consuming public in the fullest possible measure.

I have never been able to understand the sense involved in the economic thesis which states that the way to promote prosperity is to reduce wages and expenditure, which must in due course involve a reduction of consumption. I agree that a reduction of unnecessary expenditure is essential in good times or bad. But if a reduction of costs of production, prices, and wages is

forced by a deflation of the currency, or other monetary defects, it does not promote prosperity since it is bound to reduce employment and consumption still further.

Under the 'Dual System,' as we accelerate consumption, so we accelerate production. As we accelerate production, so we promote employment and again consumption. As we still further accelerate production, so we lower the cost of each unit produced to its lowest point, which must be the natural point of stability. Costs of production are lowered by increasing the quantity of production and wages, and not by reducing production and wages. Hence the 'Dual System' promotes employment with rising wages, and, as a corollary, promotes falling costs and prices in all manufactures and agricultural products capable of quantity production; subject, of course, to the Law of Increasing and Diminishing Returns.

It may be said that in adopting the 'Dual System' we should soon reach the point of saturation. All the better, if the tendency is that way. But as long as we have starving populations in the world, we have a long way to go before we reach the point of saturation. Even if we do approach it, there are natural correctives, and these are (*a*) increasing wages so as to increase consumption, and (*b*) shortening the working week. All improvements effected in the arts of production should not only be passed on to the consuming public, but to labour as well. Furthermore, an extension of leisure will lead to a development of the arts and architecture, which, in turn, will lead to a further increase of employment. And a cheapening of costs of production will make great works possible which otherwise would be impossible.

CHAPTER XX

COMMERCIAL AND FINANCIAL BANKING

The recent bank failures in the U.S.A. have not been due to the extensive re-discount facilities provided by the Federal Reserve System, but to the inordinate provision of bank credit for financial banking, which the increase of re-discount facilities by the Federal Reserve System has enabled the member and non-member banks to provide. No banking system need be afraid of commercial banking if conducted under the regulations imposed by the Federal Reserve System. Commercial banking is concerned with the discounting and re-discounting of eligible bills of exchange. Such bills are considered to be "self-liquidating paper," since they are drawn against manufactures and agricultural products—the necessaries of life—in their various stages of production and distribution. They cannot be drawn against the means of production, *i.e.* capital assets, such as agricultural land, factories, plant, mines, railways, etc. Capital assets are financed by bank credit, *i.e.* financial banking. Commercial banking is, therefore, concerned with production and distribution and financial banking with capital assets. The failure of the system of financial banking in the U.S.A. does not call for the condemnation of the commercial system of banking, which experience has proved to be the soundest part of any banking system.

In the absence of an extensive national debt, such as exists in Great Britain, the ratio of 10 to 1, as between deposits and cash held by the member banks of the

U.S.A., is excessive,[1] particularly as all commercial banking is, in effect, now transferred to the care of the Federal Reserve System. The maximum ratio is more like 7 to 1. If the Federal Reserve System were able to control all bank ratios, there would be no need to resort to a manipulation of the re-discount rate to correct excessive speculation, which rate, in reality, exists for re-discounts only. Commercial banking and financial banking are two separate institutions within a monetary system, and a clear distinction should be made accordingly. If there is one thing that the Federal Reserve System has proved to the world, it is that it is possible to have an orgy of speculation in land, buildings, stocks and shares, without promoting inflation in commodity prices. The reason for this is that under the Federal Reserve System, the control of the prices at which manufactures and agricultural products are sold is now definitely transferred to the producers. The implications of the Quantity Theory of money, in so far as they apply to commodity prices, have been neutralised. The reason being that re-discounts (which originate legal tender money) are increased or decreased proportionately with the increase or decrease of production. In this way, inflation and deflation are eliminated, and as commodity prices, in effect, have to be pre-determined before credit is expanded proportionately with production, automatic

[1] The ratio is apparently more like 15 to 1. The Chairman of Lloyds Bank recently said: 'A distinguished American banker and economist, in answer to the accusation that the United States of America had rendered its gold sterile, recently made this retort: "Our net gain in monetary gold stocks from 1914 to the end of 1929 was about $2,500,000,000 and the increase in outstanding bank credit was over $37,500,000,000, or about $15·5 of new credit for each dollar of new gold. Whatever that may be it is not sterilisation."' If this statement be true, the inflation of security values that has taken place in the U.S.A. has outstepped the bounds of propriety. Had the ratio of new credit for each dollar of gold been restricted to a ratio of even 10 to 1, which is more than ample for all legitimate purposes, the United States would not require all the gold she now possesses. But as she permits an inordinate inflation of financial credit, of course she must sink her gold reserves at the base of the pyramid of this inflation in order to buttress it.—J. T. P.

stabilisation is established, *i.e.* prices tend towards lowest cost and remain in the vicinity.

In Great Britain, however, owing to the existence of her National Debt, which is at least 100 per cent. greater than in any other country in the world, the bank ratios should not be lowered below 9 to 1 (deposits to cash) until substantial redemptions of debt have taken place, since it is essential to provide full banking facilities to the holders of Government securities, without prejudice to the holders of other securities. In the event of a change being made in monetary policy, the correct ratio to be employed should be determined by agreement after consultation between the joint stock banks and the Bank of England.

It should also be borne in mind that Great Britain is a holder of about £4,000,000,000 of foreign investments, and if London is to be made the money market of the British Empire, adequate financial facilities should be provided. The development of commercial banking should, through the increase of currency which it provides, increase credit facilities for financial banking, the limits of which should be determined by arrangement as suggested in the previous paragraph.

Notes to Chapter XX

Since they bear intimately on the subject under discussion, I have deemed it desirable to add as notes to this chapter, in order to complete the history of the work, most of the supplementary answers which I added to the Minutes of my oral Evidence submitted to the Committee on Finance and Industry, as follows :

'Under the new plan proposed, the joint stock banks would be called upon to obtain a better security than they have hitherto been willing to take. If those banks have made losses on overdrafts, it would have made no difference if the losses had been made on promissory notes or bills. It is true that currency would have been issued against the bills by the Central Bank, but the losses would have been minimised because purchasing power would have been increased. In any event when the bills fell due for repayment, the currency would have been reduced by a corresponding amount. This demonstrates once more the automatic nature of the scheme.

'I would like to emphasise that the change in mechanism which I propose does not involve any serious departure from existing practice. If the joint stock banks are merely asked to convert their eligible credits into commercial bills of a new form, embodying new legal implications, with a view to re-discounting them at the Bank of England, there can be no increase of risk in so doing. Overdrafts form the main part of the credit structure, and there can be no increase of risk involved by merely transferring the best of them, *i.e.* consumptive credits, to the base of the credit structure. In the creation of new consumptive credits, the joint stock banks would still retain their full discretionary power unimpaired, and the questions to which they would require satisfactory answers from their customers before granting credits under the plan proposed would be as follows :

(*a*) Ratio of quick assets to current liabilities.
(*b*) Amount of capital invested and property owned.
(*c*) Earnings of business.
(*d*) Nature and marketability of stock.
(*e*) Quality and rate of turnover of stock.
(*f*) Location of business.
(*g*) Character of the business organisation.
(*h*) Insurance carried.
(*i*) Nature and intensity of the competition.

'Subject to these questions being satisfactorily answered, any objection that might be raised that the commercial bills were merely "one-man bills" would be invalid, because, in the case of overdrafts, the joint stock banks in effect take "one-man overdrafts" and even then not always in the safest form.

'As regards the suggestion that the form of bill I propose cannot be re-discounted by the Federal Reserve Banks, I am forced to the conclusion that this and succeeding questions on the same point are based upon a misapprehension of the powers and practice of the Federal Reserve Banks. The Regulations of the Federal Reserve Board define the character of a note, draft, or bill of exchange, eligible for re-discount at a Reserve Bank, *inter alia*, as follows:

(*a*) It must be a negotiable note, draft, or bill of exchange, which has been issued or drawn, or the proceeds of which have been used or are to be used in the first instance, in producing, purchasing, carrying, or marketing goods in one or more of the steps of the process of production, manufacture, or distribution. (When used in this Regulation the word "goods" shall be construed to include goods, wares, merchandise, or agricultural products, including livestock.)

(*b*) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings, or machinery.

(*c*) It must have a maturity at the time of discount of not more than ninety days, exclusive of days of grace; but if drawn or issued for agricultural purposes or based on live stock, it may have a maturity at the time of discount of not more than nine months, exclusive of days of grace.

(*d*) It may be secured by the pledge of goods or collateral, provided it is otherwise eligible.

'These bills or notes can, therefore, originate as one name bills backed by the member bank for re-discounting purposes, and from the above Regulations and the statements of various authorities on their interpretation, it appears to me to be beyond doubt that the type of bill suggested under my scheme would be eligible for re-discount under the Federal Reserve System.'

As eligible bills would be entitled to a rate of discount not exceeding 2½ per cent., and as this rate would be much lower than the ruling rate of 5 per cent. on overdrafts, the producers would be only too willing to contribute, say, an extra ½ per cent. towards an insurance fund (under the control of the Bank of England or of an independent authority) to guarantee the

repayment of all the consumptive credits created under the plan proposed. This insurance would, in effect, be an acceptance credit, and would protect the joint stock banks against all risks of non-payment. It should be compulsory on all borrowers of consumptive credits to contribute the agreed rate to the insurance fund.

The principal result to be attained from the proposed reforms is the rationalisation of banking and industry as a comprehensive unit. The producers would ultimately become distributing centres of credit for their own productions, but not necessarily based on bank credit, and would take such bank credit as they required from the joint stock banks in the prescribed form. The banks would obtain a stronger and more liquid security thereby, and in such a form as would enable them to re-discount at the Central Bank without risk to the latter. The system would ultimately tend to place the whole system of distribution under the control of the producers, with, I hope, a reduction in cost.

CHAPTER XXI

THE QUANTITY THEORY OF MONEY AND THE USE OF MONEY

STATED in its simplest form, the Quantity Theory holds that prices will vary in accordance with the volume of work which the quantity of money may be called upon to perform. If the quantity of money remains the same and the quantity of production is increased, prices will fall. (Deflation.) If the quantity of money is increased and the quantity of production remains the same, prices will rise. (Inflation.) But it has to be borne in mind that, under the theoretical gold standard as practised by the Bank of England, money includes currency and credit. In his conception of money, the orthodox economist does not draw any distinction between currency and credit—they are both classified under the heading of money—the result being that the implications and reactions that arise out of the uses of money are not as fully appreciated as they ought to be. If we study carefully the following observation by John Stuart Mill, taken from his 'Principles of Political Economy,' vol. ii, p. 69, we shall find that he had this point in mind :

> The proposition which we have laid down respecting the dependence of general prices upon the quantity of money in circulation must, for the present, be understood as applying only to a state of things in which money, that is, gold or silver, is the exclusive instrument of exchange, and actually passes from hand to hand at every purchase, credit in any of its shapes being unknown. When credit comes into play as a means of purchasing distinct from money in hand, we shall hereafter find that the connection

between prices and the amount of the circulating medium is much less direct and intimate, and that such connection as does exist no longer admits of so simple a mode of expression. But on a subject so full of complexity as that of currency and prices, it is necessary to lay the foundation of our theory in a thorough understanding of the most simple cases, which we shall aways find lying as a groundwork or substratum under those which arise in practice. That an increase of the quantity of money raises prices, and a diminution lowers them, is the most elementary proposition in the theory of currency, and without it we should have no key to any of the others.

Mill clearly held the view that the Quantity Theory was mainly concerned with the currency in circulation, *i.e.* gold and silver, and not with bank credit, 'which, when it comes into play . . . is much less direct and intimate . . . and does not admit of so simple a mode of expression.' It is also to be observed that Mill based the implications of the Quantity Theory on gold and silver in circulation, in which he was right, because the expansion of consumption, and ultimately of production, depended primarily upon an expansion of the currency in circulation, *i.e.* gold and silver coin. But whilst the Quantity Theory holds good if based on a gold and silver currency, it does not apply to a currency that is based and secured upon eligible bills of exchange, because in this case production has to precede all expansions of the currency, thus ensuring the pre-determination of prices. In other words, the control of prices is transferred away from money to the producers, who regulate them in accordance with the volume and cost of production, which is the correct scientific procedure. In this way, the implications of the Quantity Theory are stabilised, and stabilisation in commodity prices follows.

Sir Robert Peel supported the view expressed by Mill when he said :

The proposition which we have laid down respecting the dependence of general prices upon the quantity of money in

circulation must be understood as applying only to a state of things in which money, *i.e.* gold and silver, is the exclusive instrument of exchange and actually passes from hand to hand at every purchase, credit in any of its shapes being unknown.'

It will be thus be shown that both Mill and Peel attached considerable importance to that portion of the currency in circulation that was free from the control of the banks. This point should be borne in mind as the argument develops.

They were both evidently anxious to draw a distinction between the effect produced by an expansion of currency upon prices and the effect produced by an expansion of bank credit upon prices. But neither of them made it clear that if an expansion of bank credit takes place, coincident with an expansion of currency based exclusively or theoretically upon gold, the rise of prices would be accentuated by reason of the increased demand that would arise. This merely confirms my view that, within the banking system as a whole, there should be a clear distinction drawn between commercial banking and financial banking, and that a mechanism should be devised that would prevent expansions of credit and currency from having any influence whatever upon commodity prices.

That this procedure is essential may be gathered from the following quotation taken from the very able speech made by the Right Hon. Reginald McKenna to the shareholders of the Midland Bank (January 21, 1921). In view of the vast increase of world population, and of the science of production, gold and silver no longer can fulfil the function for which they were originally intended. The prestige of gold now consists not in being the standard of value, but, as Mr. Robert Benson has stated, 'in being the best possible reserve for a central bank—the most saleable thing in the world wherewith to settle international balances of account.' It is therefore

desirable that we should point out the present defects of the Federal Reserve System, with a view to improvement, and not to condemn the system merely because the defects exist. As the proverb says : ' There can be no progress without change.'

The quotation from Mr. McKenna's speech is as follows :

> The question of the use of money is not less important than the rate of turnover, which after all is primarily an effect and only secondarily a cause of business depression. It has been seen that in America a relatively small part of the additional money provided by the central banks was used in trade and industry. Much more was employed in speculation, which was notoriously carried to an extreme. Indeed, near the end of the period the funds thus absorbed became so great that the money used in trade, properly speaking, appears to have actually declined, though an increase was still shown in the total volume. Some speculation in commodities, securities or other capital values goes on at all times and fulfils a legitimate and useful function, but in this case it rose to wholly abnormal heights and reached a point at which the Federal Reserve Banks, given the existing banking structure, had no power of effective resistance. It is clear that the policy of a Central Bank in relation to the total quantity of money may be wholly nullified by violent changes in the amount devoted to speculation.
>
> The importance of the use of money has frequently escaped attention, particularly in discussions and attempted applications of what is commonly known as the Quantity Theory of money. The equation which this theory, in its simplest form, adduces is in reality a truism, for it says in effect that the amounts spent by individuals and combinations of individuals in buying goods and services equal in the aggregate the sums paid for those goods and services. Unfortunately, the unduly simplified statement of the equation has led people to suppose that the price level is governed by the volume of trade transacted, the quantity of money outstanding, and the rate at which money circulates, whereas the truly relevant quantity factor is not the money outstanding, but the amount currently used in buying goods and services.

With the views thus expressed by Mr. McKenna, I entirely agree. The defects prevalent in the American

banking system as a whole, and the bank failures, have nothing whatever to do with the Federal Reserve System as such. As I have already indicated, if the ratios at which the member banks and non-member banks are able to extend credit on financial transactions were controlled by the Federal Reserve Banks, the whole of the difficulties to which Mr. McKenna refers, and which I have already pointed out in my book, 'The Dual System of Stabilisation,' would disappear.

The Federal Reserve System, like the Banque de France, is mainly concerned with commercial banking, whereas the member banks of both systems are mainly concerned with financial banking. Now as the Central Banks extend re-discounts under the commercial banking system, with which they are solely concerned, they either extend the currency in circulation or increase the deposits held at the Reserve Banks by the member banks, which increase of deposits is, in effect, the same thing as increasing the currency in circulation, for both are treated as cash; the reason being that such deposits are convertible into currency and the currency is convertible into deposits.

The member banks are permitted to expand financial credits at the ratio of 10–15 to 1, *i.e.* deposits to cash held. Now as industry and trade become prosperous and increase re-discounts, it is obvious that the basis of financial credit extends. And as securities rise in value because of this, more credit will be required to finance the same number of securities. If therefore we classify credit and currency as money, a mistake is made, because those who benefit from the inflation of security values must do so at the expense of currency holders, whose currency cannot be inflated, since such currency is fully covered by liquid wealth in one form or another at pre-determined prices of a stabilised character. Let us assume for the sake of argument that commodity

prices are stabilised, and that, in consequence of speculation and the ability of speculators to borrow freely, securities rise in value by 500 per cent., then the holders of securities would have had their purchasing power increased by 500 per cent. over that of currency holders. From this we see that we should think in terms of currency and credit, and not of money only ; at any rate, until credit has attained a more stabilised form.

It will thus be seen that the control by the Central Banks of the ratios at which the member banks can lend is essential, and that a ratio of 10–15 to 1 is much too excessive. Furthermore, if the prices of natural materials are inflated because of excessive speculation, costs of production and the cost of living must rise unnecessarily ; hence an unequal distribution of wealth must ensue. House and office rents may also be affected.

In the U.S.A. it is certainly desirable that the ratios should be controlled by the Federal Reserve Banks and reduced from 10–15 to 1 to somewhere about 7 to 1. In Great Britain, however, until a substantial reduction of the Debt has taken place, at about 9 to 1, so that the holders of other securities may readily obtain their normal credit facilities. It will thus be seen that a strict classification of credit and currency, and their uses as money are important considerations. If, however, the ratios at which the banks can extend credit are strictly controlled with a view to stabilisation, there can be no objection to classifying credit and currency as money.

After discussing the question, 'What is a Pound ?' Sir Robert Peel quoted Lord Liverpool as saying, 'Paper currency, strictly speaking, consists only of bills or notes payable or convertible into cash on demand by the person who issued the same at the will of the holder.' 'That appears to me (Sir Robert went on to say) to be the true definition of paper currency as distinguished from paper credit. It is the substitute for, and immediate

representative of, coin, and with coin it constitutes "money." And if you will adhere to the standard of value, and will adopt such measures as shall ensure the uniform equivalency of bank notes to coin, you may safely in my opinion leave untouched other forms of paper credit and entrust the regulation and control of them to individual caution and discretion.'

But it is obviously clear from what I have said that we cannot leave the regulation and control of the expansion of financial banking 'to individual caution and discretion.' Our weights and measures, and the yard stick, are clearly and definitely defined. The measure of value, into which all things that have value are convertible, should be equally as clearly and precisely defined, *i.e.* stabilised. Furthermore, as excessive speculation will always be effectively controlled if the ratios are controlled, the need for an open market policy, or for the present method of manipulating the Bank Rate, in order to check speculation and force deflation, with their prejudicial effects on industry and trade, can be wholly avoided.

Furthermore, in view of the need for an economy in the use of gold, there is no reason why we should continue the rule that currency should be convertible into gold at the will of the holder. Currency notes should only be payable in gold on demand by any Central Bank, which rule would have the effect of minimising speculation in the foreign exchanges, and prevent the shipment of gold from one country to another by individuals and banks with a view to snatching profits. It should be an easy enough matter to settle the balances of payment between countries, monthly, quarterly, or half-yearly, through the Bank of International Settlements, the one and only useful service which this Bank could render to the Central Banks of the world. Gold is the most readily saleable thing in the world, and the only wealth

product that can be handled conveniently by Central Banks, but we have made too much of a fetish of the rule, 'payable in gold at the will of the holder.' This has caused us to worship gold unnecessarily. The holder's only real concern is that the foreign exchanges are maintained at parity, which should be the business of the Central Banks and the Bank for International Settlements, so that his purchasing power may be available in any country. The clearances of currency notes and cheques should be effected in such manner as the Central Banks, in agreement with the Bank of International Settlements, may direct.

The greatest need of the moment, and one which transcends all others, is, that Central Reserve Banking should be reduced to a uniform practice in all countries throughout the world. This will not be possible until the gold reserves of the world are handled on the most economical basis possible, and the suggestion put forward should permit of this being done. The most paradoxical thing in the world to-day is that no two Central Banking Systems work to the same fixed rules, and yet we are supposed to be living in an enlightened age.

CHAPTER XXII

REVENUE IMPORT DUTIES

As was stated by Adam Smith : ' It is not by augmenting the capital of the country, but by rendering a greater part of that capital active and productive than would otherwise be so, that the judicious operations of banking can increase the industry of the country ' ; and ' In order to put industry into motion, three things are requisite : materials to work upon, tools to work with, and the wages or recompense for the sake of which the work is done. Money is neither a material to work upon, nor a tool to work with ; and though the wages of the workman are commonly paid to him in money, his real revenue, like that of all other men, consists, not in the metal pieces, but in what can be got for them.'

As I have indicated, the depression in the basic industries is largely due to the weight of taxation. A reflex action of this is a high costs level which impairs the competitive power of the basic industries, and which in turn causes Great Britain to be a better market to sell in than to buy in. If, then, the high costs level in Great Britain is due to the weight of taxation, in what way can it be neutralised ? There are two ways in which it can be neutralised, and these are (1) through a redistribution of the weight, and (2) through the creation of substantial Budget surpluses, without increasing the rate of taxation, in order that substantial remissions of taxation may be made.

As regards (1) a redistribution of the weight implies

a transfer of the weight of taxation which bears directly on costs of production to the non-active elements, the most important of which is imports. Here again I will quote Adam Smith : 'The second case, in which it will generally be advantageous to lay some burden upon foreign for the encouragement of domestic industry, is, when some tax is imposed at home upon the produce of the latter. In this case, it seems reasonable that an *equal* tax should be imposed upon the like produce of the former.' If it is true to say that the weight of taxation largely enters into costs of production, then it is true to say it becomes a tax on industry, so that at least an equal tax should be imposed on imports.

If confirmation is required that the weight of taxation is largely shifted to costs of production, accentuated by the return to the theoretical gold standard in 1925, and the increase of foreign investments, and that these, taken together, have impaired the competitive power of the basic industries, it is to be found in the figures in the table on p. 164. Attention should be given to the figures under 'Excess as a Percentage of Retained Imports,' the implications of which are serious enough.

Provided the monetary system would allow of a proportionate increase of the quantity of money with the quantity of work done within the country, £150,000,000 of taxation now thrown directly on to costs of production could be transferred from the present taxation imposed under the items food, drink, and tobacco to those imports that could be produced within the country. It cannot be said that the cost of living or costs of production would be increased thereby, for the taxation to be transferred is already included in the cost of living and, as a corollary, costs of production. The Free Traders have hitherto said that we cannot tax the imports we can produce, because it would mean an increase in costs of production or the cost of living. They claim that

Excess of Total Imports over Total Exports

(Millions of £'s)

1907.	1911.	1913.	1919.	1920.	1921.	1922.	1923.	1924.	1925.	1926.	1927.	1928.	1929.	1930. March Quarter.
128	124	134	663	379	276	180	212	336	394	466	386	352	382	94·9
Excess as a Percentage of British Exports.														
29·9	27·2	25·5	83·0	28·4	39·3	25·4	27·7	42·0	51·0	71·5	54·5	48·7	52·5	57·8
Excess of Exports of Home Manufactures over Retained Imported Foreign Manufactures.														
214	225	243	383	719	372	366	350	353	328	248	267	287	269	53·4
Excess as a Percentage of Retained Imports.														
167	164	142	148	179	171	180	152	133	114	85·8	90·0	98·3	88·2	71·3
Average Sterling Rate on New York.														
4·867	4·867	4·867	4·426	3·664	3·849	4·429	4·575	4·417	4·829	4·858	4·861	4·866	4·857	4·862

people would have to pay more for what they have to buy. But, under proper mechanism, import duties imposed with a view to an equitable distribution of taxation—*i.e.* for revenue purposes only—cannot benefit the producers to the extent of a fraction of 1 per cent. of the duties imposed.

The imposition of import duties should be confined to the commodities that can be produced within the country, subject to the potential productive power of such commodities being greater than the potential consumption. Where the potential productive power is less than the potential consumption, then the import duties should only be imposed for a length of time in any year at which it can equal consumption. To extend them beyond this time is to create Protection and cause prices to rise, *i.e.* owing to the demand being greater than the supply, producers would fix their prices at a point which included the value of the import duties. Import duties can only be neutralised by potential productive power if it exceeds potential consumption. Import duties of the kind recommended are the only true forms of neutral taxation. They are termed 'neutral' because they can be neutralised by the productive power of the country, provided it is in excess of potential consumption. The Free Trade conception of taxing those things we cannot produce, and those articles of food we desire to consume—on the assumption that it was taxation for revenue only—is the most direct form of taxation it is possible to conceive, since it enters into the cost of living, and, through this, into costs of production.

Under the 'Dual System of Stabilisation' the sole object of imposing revenue import duties is to weight any goods that could be produced within the home market with a fixed portion of the burden of taxation that has to be borne by the home producing industries. It is immaterial whether the volume of imports to be

taxed yielded the desired revenue or not. All that is desired is to impose a fixed weight of taxation on foreign imports, and which they would have to pay if they came in, thus definitely establishing the principle that all who share in the trade of the country should share in the cost of its upkeep.

It may be argued, of course, that to the extent to which the import duties prevent the goods coming in, to that extent would the contemplated revenue from the import duties be lost. But under the new economic system proposed, the real objective behind the weighting of the imports is to create a corresponding increase in the Budget surplus. The greater the weight the greater the surplus should be, *i.e.* the greater the restriction the greater would be the Budget surplus.

Whatever revenue would be lost by reason of the imports diminishing, the Budget would gain from the taxation of the increased profits that would accrue to the home producing industries in consequence of the increase in internal production, and which profits are, of course, subject to income tax. In addition to this, there would be large economies to be effected (1) in the interest charges payable on the national debt in consequence of the cheaper money rates that would prevail, and (2) in the social services in consequence of the reduction of unemployment. In fact, it is certain that under the new system the beneficial reflex action on the Budget would be greater than the inverse ratio normally to be derived from the imposition of import duties, because of the numerous imperfections in the economic system that would be eliminated, and which are, at the present time, extremely costly to the nation.

This statement can easily be proved. We have seen in the notes to Chapter X that £350,000,000 of the excess of imports is received in satisfaction of interest receivable on foreign investments and short interest and com-

missions on foreign business. These particular imports are not covered by actual exports, although in earlier years it was the excess of actual exports in each year that built up the foreign investments. The paradox that has now arisen is that the interest receivable on our foreign investments is actually shutting off the export of manufactured goods which formerly built up the investments; and the credit required to finance the foreign investments which are listed on the London Stock Exchange, and which naturally have to be financed in this country, is likewise curtailing the credit available to production in this country. To this we have to add the reparation payments that have to be made by Germany which the latter can only discharge by an export of goods, and as Great Britain is the largest available free market she has to bear the brunt of this transaction.

As our foreign investments increase, so must the excess of imports increase in order that the dividends receivable thereon may be paid. No one can object to the nation increasing its wealth abroad, but we can certainly all object if it results in a diminution of the nation's wealth productive power and the employment which it offers.

Import duties ought to be levied with a view to curtailing the import of all those things we can manufacture for ourselves, and this will give us the choice of doing three things: (1) Taking a greater volume of natural materials and other luxuries than we can afford to take at present, and/or (2) enabling the Bank of England to increase its gold reserves as is now being done by the Central Banks of the U.S.A. and France, and (3) still further increasing our foreign investments. If this policy is pursued, the two latter countries would not have the rich picking they have at present.

The world can adopt universal Free Trade in exportable surpluses, *i.e.* each nation can exchange the surplus

of its productive power for the surplus productions of other nations which it cannot produce for itself but which it could use. In this way only can we bring about the greatest distribution of wealth. When a single nation exposes the whole of its productive power to world competition, it handicaps its producers. Free Trade should be confined to exportable surpluses, and when this is done the volume of international trade will be greater—not less—than it is to-day.

> When the produce of any particular branch of industry exceeds what the demand of the country requires, the surplus must be sent abroad, and exchanged for something for which there is a demand at home. Without such exportation, a part of the productive power of the country must cease, and the value of its annual produce diminish !
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> It is only by means of such exportation, that this surplus can acquire a value sufficient to compensate the labour and expense of producing it. The neighbourhood of the sea coast, and the banks of all navigable rivers are advantageous situations for industry, only because they facilitate the exportation and exchange of such surplus produce for something else which is more in demand there.
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> The carrying trade is the natural effect and symptom of great national wealth ; but it does not seem to be the natural cause of it. Those statesmen who have been disposed to favour it with particular encouragements, seem to have mistaken the effect and symptom for the cause.[1]

[1] *The Wealth of Nations* (Adam Smith), vol. i., bk. ii., chap. v., p. 352.

CHAPTER XXIII

ON WAGES

UNDER the 'Dual System of Stabilisation' wages will be paid out of the cost of producing or distributing the products on which labour may be employed, and it is the only effective way in which wealth can be distributed to labour. In an economic system based exclusively, or theoretically, on gold, wages are drawn from monetary and capital sources, and if these be restricted wages and employment will be restricted. This statement is easily proved by the known fact that, in a metallic money system, the price of a product is determined by money, and that the amount it can afford to pay is determined by its quantity. Under the 'Dual System' price and value will mean one and the same thing, because wages will be paid out of the products on which labour may be employed. As I have shown, sound credit is that which originates in production and terminates in consumption, so that if this form of credit is extended, labour will in fact be paid out of the production and distribution of the products upon which it may be employed.

The doctrine that wages must depend upon the ratio which may exist between the quantity of work and the quantity of money based on gold and available for production is so absurd that one wonders why it should ever have been allowed to prevail. The poverty, misery and suffering which this doctrine has occasioned during the last two centuries have been appalling. Money cannot, and ought not to be allowed to,

operate as a separate system apart from production, particularly if the bulk of it is employed in financing securities of all kinds. The monetary system and the productive system ought to operate as one unit, for if wages are to be paid out of the production and distribution of the products on which labour may be employed, then the quantity of money should rise and fall proportionately with the quantity of work which it is called upon to circulate.

Under the quantity theory of money based exclusively, or theoretically, on gold, it is held that more labourers can be employed at low wages than at high wages. Under the 'Dual System of Stabilisation' it is held that more labourers can be employed at high wages than at low wages. This is the material difference, and there can be no question as to which of the two is the soundest from a social point of view.

Under an exclusive, or theoretical, gold basis system the quantity theory of money rules that if the quantity of money available for production remains the same, any increase in the quantity of work which it is called upon to perform must necessitate a fall in prices and wages, so that the increase of production may be consumed, and so that the additional labourers employed may obtain their subsistence wages. This is precisely what is happening in Great Britain to-day. But is it not obviously absurd that in spite of the vast increase of Great Britain's wealth productive power, that the wages of her labourers should tend to a minimum subsistence level, whilst at least 40 per cent. of her potential productive power remains unemployed. We are here associating poverty, starvation and want with the improvements effected in the arts of production, whilst in reality they are due to the defects of monetary policy and the Free Trade system. Can it truly be said that we are making the greatest use of the increased productive power which we now possess, and of which,

even twenty-five years ago, the boldest imagination could not have dreamt?

The *Morning Post* recently issued an appeal to all Christendom to protest against the execution of Christians in Russia, which had my greatest sympathy and support. Whilst I hope the protest will be proceeded with energetically, nevertheless it would have more prospect of success if those who profess Christianity would find a remedy for the protest which the Bolsheviks and Communists raise against what they term the 'capitalist system,' and which they claim is associated with Christianity, but which is not true.

What is the general complaint of the Bolsheviks and Communists? It is that the capitalist system does not bring about an equitable distribution of wealth. For this reason it is considered that the teaching of Christianity is hypocrisy, and that it is one of the agents employed by capitalists in defence of the capitalist system. Most ministers of religion also defend capitalism—and perhaps quite rightly—but it is here that the inconsistency apparently arises. Yet ministers of religion have to be excused, since they are unable to distinguish between the proper uses of capital and of money.

It all points to the fact, however, that the true economic system has yet to be found, and that there cannot be two true systems. God has placed an abundance at the disposal of mankind through nature, but man himself has placed impediments in the way of his own access to it. When the economic system accords more with the laws of nature, then we shall be able to offer more to mankind than Bolshevism or Communism can ever offer.

We have been taught that man must live by the sweat of his brow. The cost of what the earth can yield is the effort in labour. On the surface of the earth is to be found her dividends, such as wheat and vegetables, and under the surface, her capital, such as minerals. But both must be won by labour and effort. As the cost of all other

utilities must be the effort in labour, why need there be any unemployed or poverty? What stands in the way? As soon as the true economic system is observed, the opposition to Christianity and capitalism will disappear.

The great principles of economic science are true; the emancipation of mankind will come when we have observed the true mechanism under which they can be operated truly, without imposing injustice, distress and poverty. Until this stage has been reached, we cannot hope to attain universal peace. But when it has been reached, moral science and religion will come into their own. As the economic system stands to-day, a hungry man is not disposed to listen to the beautiful theories of moral sentiment. He desires first of all economic emancipation. He holds that if Christianity is true, it should find expression in the economic system. And so it should.

What puzzles the Socialists of to-day, and makes them suspicious of the capitalist system, is the association of poverty and starvation with the great progress that has been made in the development of the arts of production. In the last twenty-five years machine power has been developed tremendously, costs of production per unit of goods produced have been reduced, yet the wealth which this machine power could create is not accessible to the point at which unemployment, poverty and starvation can be removed.

Our powers to satisfy the needs of the people have been increased, yet many are unable to buy. We have a large number of unemployed who are willing to work, and barter their services with the services of those who are employed, yet they are unable to do so. This is the central fact from which arise the industrial, social and political difficulties that are at present perplexing the world. We need only turn to China, India, Russia and Mexico. All the political upheavals that exist are mainly economic in origin. Money is the restrictive

influence, and statesmen and politicians grapple with the problem in vain. From the defects of the monetary system based on gold arise the present social difficulties which perplex the World. It is the problem which Fate keeps presenting to civilisation, but because its scientific aspects are remote from everyday life, it is difficult to secure a public interest in them, yet the solution is bound to come. We cannot educate men and refuse to find them employment. We ought not to condemn them to poverty and starvation if these can be avoided, as they can be.

But it would be a great mistake to assume that you can make the poor richer by making the rich poorer. What we have to aim at is to make both the rich and the poor richer. What we have to do is to bring about a larger distribution of wealth, which can only be done through rising wages and falling prices. Before we can divide, we have to create ; and the more we create the more we can divide.

Productive power, if it produces an income, may be termed a capital asset. Hence the reason for the expression we use—'Wealth productive power.' But if productive power ceases to produce an income, it becomes a capital liability. It is for this reason we must be careful to define clearly the nature of capital and wealth, for a great deal of confused thinking exists on this point.

We ought not to attempt to redistribute capital, particularly if it is wealth productive, for it represents the means of production, built up with infinite care and patience through generations of effort by their past and present owners. We can, however, with the full approval of all concerned, create more and divide more, *i.e.* increase and more equitably distribute income. Labour has no desire to hoard gold. What it desires to hoard are the good things of life. It wants more of them, that is all ; and, what is more important, it is prepared to earn them.

The owners of capital—and are we not all capitalists ?—should be left to assume that broad personal moral responsibility towards their fellow men which it was intended they should always assume ; and how many of them would deny themselves the privilege and pleasure, if they had the means and the opportunity, of assisting their fellow men ? To-day is an age of self-preservation instead of co-operation. Whose fault is it ? We cannot truthfully say it is the fault of the capitalists, and this will become more apparent whenever the public is able to appreciate more clearly the distinction that should be drawn between the uses of capital and of money, *i.e.* capital and wealth.

Notes to Chapter XXIII

The argument in this chapter is directed against the following orthodox thesis :

' Labour has not only no natural price, but also no market price, no price at all. It is not purchased or sold ; no one buys it, no one sells it, no one would take it as a gift. What is bought and sold is not the labour, but the commodities and services produced by the labour ; not the labour, but the work done by the labour.'

The writer responsible for the foregoing quotation no doubt endeavoured to translate in a blunt and simple way one of the implications of the Quantity Theory of Money based on a gold standard, or a theoretical gold standard. Nevertheless, the doctrine is inhuman, and this implication of the Quantity Theory probably originated the Free Trade movement. It created a scientific fact ; hence the reason for the great mass of confused thinking and misunderstanding which has arisen from it.

CHAPTER XXIV

THE PROBLEM OF OVER-PRODUCTION

It has been said by certain bankers and economists that what the world is suffering from is over-production, and that, in Great Britain in particular, the banks are overlent to industry. If this statement is made in all sincerity, then it reveals an ignorance of the true cause of the depression in Great Britain and of the fall in the general level of world prices. If it were true to say that the banks were overlent to industry, then prices would be rising and not falling. We should be in the midst of a period of inflation ; but the true fact is that we are in an acute period of deflation.

As the bulk of the credit created in Great Britain originates in Government debt and other securities, then the amount of credit that can originate in production and terminate in consumption has been limited. This proposition can be stated in more simple terms by saying that the volume of credit available to production has been limited, and that the currency that could be put into circulation has been restricted to its present dimensions. The absence of an elastic system shortens the consumers' buying power, and the credit creating capacity of the joint stock banks. This is the real point at issue.

The capacity to produce and the capacity to consume have—with two or three exceptions—greatly exceeded the capacity of the monetary systems of the world to approximate them, *i.e.* if they are to continue to finance Government and other securities as well. The

consumption of commodities is restricted to a metallic money medium, and in the case of China it is restricted to silver, the value of which has fallen considerably in recent years, with disastrous results not only to the people of China, but to those countries which do an export trade with China.

Industry and trade are conducted on the basis of earning a marginal profit in terms of a metallic money, the supply of which in gold is insufficient for monetary purposes, largely because national debts are now greater than they have ever been in the history of the world, and because they have to be redeemed in terms of gold. The result of this has been to destroy the original basis of all monetary systems, namely, the exchange of commodities and services for commodities and services, otherwise known as the barter system. The principle that exports should pay for imports no longer exists. Trade is now reduced to a point where one nation tries to be more clever than the other in securing gold in exchange for exports, and in accumulating it. In one or two cases, the gold, after being accumulated, is actually sterilised, in case it may be needed in future years for the development of trade within the countries concerned. The rest of the world can go without.

The result is that the aggregate purchasing power of the world in terms of metallic money over commodities and services can only be increased through lowering wages and prices. But in view of the existence of the national debts, and the great increase of taxation throughout the world generally, costs of production and costs of living have been inordinately increased, with severe consequential losses to most producers and consumers.

An adverse factor arising out of this situation is that the lower prices—not brought about, be it noted, by an increase of production, but by the decrease of effective purchasing power—act as a brake on all enterprise

based on the production and distribution of commodities for gains in metallic money. There is an insufficiency of it for production and consumption to make it worth while to maintain enterprise at its highest point. Production and distribution are carried on for purposes of gain in money ; but as money is only useful for what it will buy, it should be anchored to the mass of commodities and not to the precious metals.

As I have indicated elsewhere, under the present implications of the quantity theory of money, demand precedes supply, so that industrial prosperity is only possible in a period of rising prices. But demand can only arise when the banks are able to extend credit ; and, in so far as it concerns Great Britain, this has to await the time when the Bank of England is able to let out more money in consequence of an import of gold.

The proper operation of the law of supply and demand is that supply should precede demand. Money should be confined to being a mere medium or token, and designed in such a way as to facilitate a barter economy internally and externally. As the wages of labour and the recompense of management should be paid out of the production on which they may be employed, so likewise new money should be created on production as it comes forward for distribution, and cancelled when it is consumed. In this way, we ensure a reversal of the present implications of the law of supply and demand.

As Mr. Hawtrey so truly says, ' Production is carried on with a view to exchange. When people work for money, their ultimate aim is to obtain the things that money will buy. Money is a mere token or medium.

' Nevertheless the *immediate* motive of economic activity is money, and anything which affects the supply of money reacts upon economic activity.

' The " supply of money " for this purpose means the

daily (or monthly or yearly) amount of money that is being spent by consumers on goods of all kinds—the "consumers' outlay." The consumers' outlay is what is spent out of the "consumers' income."'

It may be a half-truth to say, with the monetary system as it stands to-day in Great Britain, that the banks have overlent to industry, and that the banks are able to extend credit to sound business propositions, and that there is general over-production. But such statements are merely half-true, because consumers' buying power is not equal to their needs; hence the number of sound business propositions that exist must be limited. So long as we have over 1,500,000 unemployed, and so long as the majority of the basic industries are on the verge of bankruptcy, it cannot truthfully be said that there is over-production. What those people really mean when they affirm it is that there is over-production in relation to the quantity of metallic money available, *i.e.* the means of payment; and as the demand for money exceeds the supply of it, the producers must submit to the so-called law of supply and demand, which is an inexorable and penal law when the general level of prices is controlled by the quantity theory of money.

So long as we have an unemployed population, so long as the nations of the earth have unemployed populations, so long as we have the poor, poverty and distress always with us, there can be no such thing as general over-production. No man living could determine the point of saturation, if modern Central Banking practice existed in all nations. Real over-production may take place in certain sections of industry in course of time, but this would be due to a lack of balance between the divisions and sub-divisions of labour, faulty management, and an absence of adequate statistical information. But, as I predict there will be, in course of time, an increased demand by producers for labour, and that the present

demand by labour for work will cease to exist, over-production will be controlled and regulated by this factor. A further check on over-production will be the bill of exchange. As these bills will be drawn for three-monthly or six-monthly periods, should they fail to be discharged at their due dates it may indicate over-production, and bankers need not renew them unless the security is good and business conditions warrant them in doing so. Full discretionary powers in this matter must always remain with the bankers.

CHAPTER XXV

THE LAW OF INCREASING AND DIMINISHING RETURNS

A GREAT deal has been written on the Law of Increasing and Diminishing Returns, and there is not much that can be added to the knowledge which already exists on the subject. The textbooks clearly show that in the production of an agricultural product, the three chief agencies employed are land, labour, and capital, and that, for the purpose of increasing production, we may increase the supply of either of these factors. But beyond a certain point—which I term the cross-over point—we shall find that we cannot increase the produce of the land in proportion to any increase in the supply of labour and capital. Beyond the cross-over point we shall experience a diminishing return. Similarly, if we increase the amount of labour without increasing the supply of land and capital, the ratio of output per unit of labour will diminish. This, briefly stated, is the Law of Diminishing Returns as expounded in the textbooks.

In Great Britain the area of agricultural land is limited. Agriculturists are not able to derive the full advantages which manufacturers are able to do from the development of quantity production. Machine power can be duplicated, but land cannot. Land can be made to work profitably at a certain load, but beyond this it will yield a diminishing return. Nevertheless, it will always pay an agriculturist to develop his production beyond the cross-over point, *i.e.* where diminishing returns begin, so long as he is earning a profit on his

production up to the cross-over point, and so long as the value of the excess production beyond this is not less than the cost of the labour expended in securing it. All wealth comes from the soil and the more of it that can be produced at home, the better it will be for the nation.

In the manufacturing industries, the Law of Increasing Returns mainly prevails. The three chief agencies here are machine power, labour, and capital. All of the items can be increased proportionately, and any one of the items may be increased alone, with a view to securing an increasing return. The development of this law to a successful conclusion, and in so far as it applies to agriculture, depends upon there being an adequate market and an adequate purchasing power.

Now the point I would like to develop here is this : That the three agencies in production are not land, labour, and capital, or machine power, labour, and capital, because land and machine power are capital. Much of the confusion which exists in economic science is due to the use of wrong terminology. Strictly speaking, the three agencies in production are capital (which includes land, factory premises, and machine power), labour, and money. A clear distinction must be drawn between the uses of capital and of money. A labourer works for the necessaries of life, which can only be distributed to him through money, and in all our discussions of the Law of Increasing and Diminishing Returns this distinction should be clearly noted. If we do so, it will enable us to appreciate all the more clearly the full implications of this law. It will be seen that the development of production to its fullest possible extent is largely dependent on the supply of money. The more we produce, the more we can divide, but we cannot divide until we produce. To this, however, there must always be a prerequisite condition—namely, that there is in being a monetary mechanism which will facilitate distribution

and accelerate consumption, since, as I have clearly shown elsewhere, capital becomes a liability if there is an insufficiency of money co-operating with it and/or if it fails to produce an income.

There are several variations of the Law of Diminishing and Increasing Returns, which are clearly indicated in the textbooks. But it will be clear from the argument as I have developed it, that whatever applies to an individual producer must also apply to the nation as a whole. From a national point of view, an increasing return should always be expected from large scale production. It is the business of industry to promote the largest economic activity. Production must always remain service power. It must always offer the largest quantity it can in exchange for money. It must enable men to exchange their services and commodities for other services and commodities. Anything which retards this beneficent tendency retards economic development and social progress.

CHAPTER XXVI

PROPOSALS FOR THE IMPROVEMENT OF AGRICULTURE GENERALLY

No equal capital puts into motion a greater quantity of productive labour than that of the farmer. Not only his labouring servants, but his labouring cattle, are productive labourers. In agriculture, too, nature labours along with man; and though her labour costs no expense, its produce has its value, as well as that of the most expensive workmen.[1]

The capital employed in agriculture, therefore, not only puts into motion a greater quantity of productive labour than any equal capital employed in manufactures, but in proportion, too, to the quantity of productive labour which it employs, it adds a much greater value to the annual produce of the land and labour of the country, to the real wealth and revenue of its inhabitants. Of all the ways in which a capital can be employed, it is by far the most advantageous to the society.[2]

In view of the vast economic problems that Great Britain has now to deal with, it is essential that steps should be taken to intensify agricultural production within the country. In a proper economic mechanism, it is estimated that at least 500,000 more people could be employed in agricultural and subsidiary occupations, thus reducing the cost of social services by a considerable amount. For several years past, arable land has been going out of cultivation, and, in the interests of the country, this cannot be allowed to continue.

In the past, public opinion has been taught by orthodox

[1] Extract from *The Wealth of Nations* (Adam Smith), vol. i., bk. ii., chap. v., p. 343.

[2] *Ibid.*, p. 344.

economists that prosperity in the agricultural and subsidiary industries of this country could not be brought about without increasing costs of production and the cost of living. Whilst the present monetary system is maintained this is true, but it is true only because of the implications that arise out of the quantity theory of money based on gold. This theory rules that if the quantity of money remains the same, and the volume of work is increased, prices and wages must fall. In other words, people must accustom themselves to low prices and low wages if they desire the quantity of money based on gold to do the maximum work possible. Therefore, if prosperity were restored to the agricultural and subsidiary industries, and if it necessitated an increase of prices here and there, it would raise costs of production; and thus it becomes impracticable. It is for this reason I contend that the Free Trade system is not a science, but merely an implication of the quantity theory of money based theoretically on gold.

Whilst this Free Trade implication remains, it would be impossible to influence public opinion and the basic industries to support an intensification of agricultural production within the country. The only way by which we may gain the requisite support is to alter the economic mechanism, and the present implications of the quantity theory of money.

If the Bank of England were converted to a Central Reserve Bank, organised in accordance with the most up-to-date Central Banking practice, then it would be possible to meet the claims of agriculture without increasing the cost of living or costs of production. The sole aim and object of any agricultural policy should be to create substantial Budget surpluses. If, for example, a Budget surplus of at least £150,000,000 could be obtained within two years of the reform of the Bank of England and the realisation of the claims of industry

and agriculture, without increasing the weight of taxation, then any slight increase in the price of any agricultural product would not increase the cost of living or costs of production. On the contrary, the latter would decrease by reason of the remission of taxation which would follow. (See Chapter XXII.)

In so far as the cost of food is concerned within the new economic system proposed, cheapness will be a relative term. It will be determined :

(1) By the volume of free purchasing power in the pockets of the people, *i.e.* currency in circulation apart from bank cash.

(2) The total quantity of food that a man can afford to buy from his weekly wage earnings.

(3) The low prices at which he can buy general utilities. The cheaper these are, the larger will be the margin he will have available for the purchase of food, luxuries, and savings.

Under the proposals which follow, the expenses which the producers and consumers of this country would incur in conceding the claims of agriculture through prices, and not through taxation, might amount to about £20,000,000. But if by investing this money in the direction suggested we materially assist in creating the Budget surplus aimed at, a profit on the whole transaction would be shown. In other words, if £20,000,000 enters into costs of production through conceding the claims of agriculture, we would more than neutralise it by bringing in a Budget surplus of £150,000,000, the product of all the economic reforms so far suggested, which would go towards a reduction of costs of production—*i.e.* if we agree that all taxation is largely shifted to costs of production, and therefore that a reduction of taxation must naturally bring about a reduction of costs of production.

It has to be borne in mind that the Budget surplus is a national profit, and as such is the common property of the whole community. The size of the Budget surplus determines the efficacy and effectiveness of the mechanism of the economic system employed. This point is one that is often overlooked by producers and consumers generally, and is the simple explanation why the American price level is a falling one, and why it is not affected by the highest import duties in the world, or by the stabilisation of raw cotton and wheat by the American Government. In its methods of stabilising prices, however, it is to be observed that the American Government does not offer to pay subsidies, nor does it pursue a policy which involves any increase of taxation. Its economic policy is scientifically directed.

But we venture to suggest that the claims of agriculture could be met very easily in another way, without increasing the cost of living, through the simple expedient of redistributing the weight of taxation. The present economic system necessitates the imposition of customs duties upon certain articles of consumption which we are unable to produce within the country. Under the 'Dual System of Stabilisation,' all import duties—*i.e.* customs and excise—would be shifted from those things we cannot produce to those things we can produce in sufficient quantities to meet home consumption.[1] It would be possible, not only to meet the claims of agriculture without increasing the cost of living, but even to guarantee a reduction. For instance, we tax the working-man's beer about 2¾*d.* a pint, which alone produces a revenue of £75,000,000 per annum. We tax his

[1] It is not proposed to place an import duty on wheat or flour, or any agricultural produce which could not be produced in sufficient quantity to meet the internal annual consumption.

The following particulars may be of interest:

1. British wheat is sold on a basis of 63 lbs. per bushel, whereas most overseas wheat is sold on a basis of 60 lbs. per bushel. Therefore, as 8 bushels equal

tobacco 6*d.* per ounce; even his matches are taxed. From the whole of the items under the heading of food, drink, and tobacco, the Government derives a revenue of £211,000,000. It would be an easy enough matter to remit £75,000,000 of this form of taxation to the working classes, which would provide them with a handsome sum to spend on home-grown food, and, even if a few of the items were to cost them slightly more, they would be glad to pay the price for the sake of the opportunity of being able to save a larger margin out of their wages to spend on food. This is a striking illustration of what I mean by a redistribution of the weight of taxation. Under the 'Dual System of Stabilisation' Budget surpluses would continue to grow.

The proposal of subsidies put forward by certain agriculturists would not only increase the burden of taxation, but it would destroy any hope of creating a Budget surplus. The proposals which follow not only avoid the payment of subsidies, but are designed with a view to assisting in the creation of a Budget surplus of £150,000,000; £75,000,000 of this could go towards the remission of the duties mentioned in the preceding paragraph, and £75,000,000 towards the redemption of debt and the further remission of taxation. One

one quarter, British wheat is generally sold per quarter of 504 lbs., whereas most overseas wheat is sold on a basis of 480 lbs. to the quarter.

2. 400 lbs. of wheat makes a sack of flour which weighs 280 lbs.

3. From the manufacture of each sack of flour there is a by-product of 112 lbs. of grain offals.

4. In the manufacture of each sack of flour there is 2 per cent. waste.

5. The price of standard grade flour is to-day 36*s.* a sack.

6. The bakers make 94 quartern loaves to a sack of flour, which is equal to 112 loaves per quarter of wheat.

7. The price of the quartern loaf is to-day 7½*d.* wholesale and 8½*d.* retail.

8. If wheat is priced at 43*s.* per quarter, which will produce 336 lbs. of flour at a selling price of 43*s.* 2½*d.*, and if the bakers can make 112 loaves from this amount of flour, the cost per loaf in flour is 4⅝*d.* Therefore, an increase in the price of wheat by 5*s.* per quarter would only raise the cost of bread by ½*d.* If the increase in the price of wheat is 10*s.*, the increase in the cost of bread would be 1*d.*

further advantage obtainable is that we can assure the home market to the agriculturists. There is, therefore, a vast difference between the two schemes. Under the scheme which provides for the payment of subsidies, there is no assurance that the produce on which the subsidies are to be paid would, or could, be sold. In the circumstances it is difficult to appreciate why agriculturists should risk their future welfare by advocating subsidies (which are not scientific, and are unacceptable to the exporting industries) if they can obtain their objective more effectively in a scientific way.

It should be understood that natural stability based on the security of the home market is an entirely different proposition from the fixed stabilisation of prices based on the payment of subsidies by Government.

My theory is that the volume of purchasing power, under modern Central Reserve Banking practice, is anchored to the volume of agricultural production—*i.e.* the volume of industrial production is regulated by the volume of agricultural production, and the more of the latter that is done at home, the more prosperous will the country become. Natural stability is produced by eliminating inflation and deflation from the economic mechanism, assured by the adoption of modern Central Banking practice. There is a great difference between natural stability and regulated stabilisation.

In order to ensure a wide measure of acceptance by the public for the agricultural proposals which follow, a first essential is that they should be sound in all essentials. Nothing kills economic reforms so quickly as when they are subject to extensive criticism and ridicule. The proposals will, I think, reduce criticism to a minimum. To secure a wide measure of acceptance, there must be no financial liability, implied or otherwise, on the Government.

The main concern of the producers and of the

consuming public is to ensure that, whatever agricultural proposals are adopted, substantial Budget surpluses will be created, which alone can bring about a reduction of costs of production. As already indicated, any slight increase in the price of any particular product—such as bread—under the new monetary policy suggested, would not affect costs of production. The latter will, under modern Central Banking practice, be controlled by the Budget. If there is a deficit in the Budget, costs of production will increase ; if there is a surplus, costs of production will fall. Similarly, it may be said that if Government expenditure is high, costs of production will be high. If Government expenditure is low, costs of production will be low. This argument applies to the cost of living as well.

The following proposals are an attempt to set out in a practical way a means by which the growing of grain can be encouraged in Great Britain, and the consolidation of Empire trade promoted, without increasing the price of bread, the breeding of live stock, the feeding of poultry, or the production of eggs, and which, at the same time, will permit of an extensive development of agricultural production as a whole :

1. *Import Duties.*—In the case of any agricultural product where the present and/or potential productive power of the country is in excess of home consumption, import duties should be imposed. In any case where it can be shown that Home and Empire surplus production is in excess of home consumption, an import duty or restriction should be imposed. But an import duty or a restriction on the imports of any food product should be suspended or modified whenever its price exceeds the average cost of production in this country. Cost of production should include 5 per cent. on capital invested and cost of supervision. Imports from Empire sources should be admitted free as at present.

2. *Subsidies.*—No subsidy should be paid by Government on any agricultural product. Agriculturists, likewise other producers, should be able, generally speaking, to recover their costs of production from the prices at which their products are sold.

3. *Wheat.*—In the case of wheat, it should be compulsory for British millers to use 20 per cent. of home-grown wheat in the grist in the manufacture of flour. The balance of 80 per cent. of our wheat requirements should be purchased from Empire sources. The price to be paid per quarter of 504 lbs. of milling quality home-grown wheat should be the average Empire price, and any disagreement on the question of grading and price should be referred to the Ministry of Agriculture for decision.

4. *Flour, Grain Offals and the Price of Bread.*—The importation of flour should be prohibited and should apply generally in order to ensure an effective realisation of Resolution 3 and the provision of an ample and cheap supply of grain offals for the feeding of live stock. (See scheme for Rationalisation of Bacon Industry.) The price of flour and bread could not in any way be increased by this regulation beyond what it would be if the regulation did not exist.

5. *Barley.*—A market should be assured for home-grown malting barley at competitive Empire prices, and the Brewing, Malting and Distilling industries should be consulted as to the details of the legislation required to secure this result.

6. *Cereals Generally.*—Preference in the imports of cereals should be given to the Dominions and Colonies, and an embargo on the importation of cereals from sources outside the Empire should be enforced with this end in view.

7. *Meat.*—In regard to meat, other than pig products, if the above measures are taken there need be no necessity for an import duty, unless in connection with a scheme

of Imperial Preference and the development of trade with the Argentine. The law as to the labelling of imported meat should be strengthened and more stringently enforced ; all sausages and similar meat substances, in the manufacture of which imported meat is used, should be labelled, and sold as made of imported meat.

8. *Preserved Milk Products.*—The importation of liquid or tinned milk, milk powder and preserved milk products in any form should be controlled and only permitted where the sources of supply are subjected to the same rigid supervision as applies to British milk production. Milk and milk products also to come under Paragraph 1.

9. Oats, Potatoes, Hops, Poultry and Eggs, Soft Fruits, Vegetables are covered by Paragraph 1.

10. *Bacon.*—The scheme for the Rationalisation of the Bacon Industry, set forth as an appendix to this chapter, should be enforced, since it is impossible to apply import duties to imported bacon until an adequate supply of home-fed pigs of the requisite type is assured.

11. *Tinned Food and Dried Fruits.*—No import duties should be imposed on any tinned food, fruits or vegetables, or preserved or dried fruit, where it can be shown that supplies from Empire sources are insufficient to meet internal demand.

12. *General.*—Immediate steps should be taken by H.M. Government to denounce any Treaties or International Conventions which might interfere with any legislation required to give effect to any of the foregoing proposals.

13. Preference should be given to home-grown products in contracts for the Navy, Army, Air Force and other public bodies.

14. The success of any scheme for marketing any of the products mentioned above must depend on the

simultaneous control of the import and marketing of the same group of imported products.

15. All imports of agricultural products, and particularly cereals, from the Dominions and Colonies should be certified by country of origin as having been produced within the Empire.

16. Every endeavour should be made to secure from other countries from which agricultural products are imported reciprocal rights to export thereto British agricultural products.

17. The cost of transport of home agricultural products should be investigated in order to ascertain what reductions can be effected with a view to assisting the industry in promoting the effective marketing and distribution of its products.

18. In order to bring the farmers, middlemen, and the retail distributing trades under the light of publicity, arrangements should be made by which fair retail prices for agricultural produce should be announced through the Press and British Broadcasting system.

The agricultural industry is subject to special economic laws of its own, but the policy herein submitted overcomes the objections hitherto raised against the claims of agriculture being met, and is designed in such a way as will help the industrialists to promote their trade to the fullest possible extent in world markets, and particularly within the Empire. The greatest care and consideration has also been given to the implications and reactions of each detail of the policy outlined, so as to avoid any unnecessary increase in costs of production, which, if permitted, would be bound sooner or later to reflect themselves in the credit position ; and in view of the need for a change in monetary policy, due regard has had to be paid to this aspect of the question.

The following broad general principle has been conceded to agriculturists, namely, that all producers, without exception, should be entitled, generally speaking, to recover their costs of production ; but in view of the acute economic crisis which exists in world markets, that all producers should rely upon a recovery of world prices, *i.e.* world prosperity, for their profit or for an increase of their profit.

Although the development and strengthening of an Empire Economic Unit is essential, this does not mean that an Empire Economic Unit must necessarily shut itself off from world trade. On the contrary, the stronger the Empire Economic Unit becomes, the stronger will be its capacity to trade in world markets. Furthermore, when the world reverts to the barter system of trade in surplus productions, political tranquillity and economic peace will be restored to it.

The acute depression now prevailing in the agricultural industry, accentuated by the excessive importation of agricultural products, has resulted in a diminution of the purchasing power of agriculturists generally. This is one of the main causes of unemployment, the existence of which, and the extreme poverty which prevails generally, in its turn curtails the consumption of agricultural products. As all purchasing power originates in the soil, it follows that the extent of agricultural prosperity will determine the extent of industrial prosperity. It is, therefore, essential that the measures necessary to restore prosperity to the agricultural industries should be taken in hand simultaneously with the reform of the monetary system or as soon thereafter as possible. If I may modify one of the recommendations of the World Economic Conference, Geneva, 1927, I should word it thus : 'Agriculture is the occupation of the majority of workers throughout the world ; its very products represent in value the greater part of

human labour, and the exchange of its products against industrial products forms indeed *the balancing factor in national trade, and ultimately of world trade.*'

It may be said that existing treaties with foreign countries would preclude the prohibition of the importation of cereals and flour, but where such treaties exist they should be abrogated. In view of the rapidity with which indebtedness and taxation are growing, we are now faced with a real danger which must be met, and one of the most effective ways by which this can be done is to intensify agricultural production within the country.

Appendix to Chapter XXVI

Scheme for the Rationalisation of the Bacon Industry in Great Britain.

A price to be fixed for bacon pigs in this country, such price to be ascertained periodically and to rule for definite periods, say, for three months from each quarter day. The price to be fixed by the appropriate statutory authority, after consultation with the Ministry of Agriculture, the National Farmers' Union, the Bacon Association and the National Food Council.

The price to be based on the average cost of feeding stuffs for the preceding three months, in accordance with the existing practice of the Ministry. The various Government Research departments to fix the average amount of food required for the production of a score of pork, such food value to the farmer or feeder to form the basis upon which the price per score of the finished pigs is to be ascertained. Cost of production to include an agreed percentage on the capital invested.

Bacon supplies from the Dominions and Colonies to be admitted free into this country without restriction, but a gradual embargo to be imposed on supplies from foreign countries, corresponding to the ratio of increase in home production. No import duties to be imposed meanwhile, but after a period of three years the embargo to be abolished and the regulations provided for in Resolution 1 of the agricultural proposals to apply.

These proposals, if adopted, should result in relieving the farmers of all anxiety or uncertainty as to the price at which they can market their pigs.

The general effect of the foregoing policy would be to give an enormous stimulus to pig breeding and feeding in this country, to provide vastly increased employment, secure better and more uniform quality of pigs, safeguard the public by keeping prices at a reasonable level, and go far towards recapturing much, if not all, of the £40,000,000 of bacon trade which now goes to our foreign competitors.

ADDITIONAL NOTE.

With regard to the table on page 197, some people may think that the commission charges are not comparable since the share values are not equivalent The answer is that in London our transactions are mostly carried out in £1 shares and not in £20 shares, whilst in New York transactions are mostly carried out in $100 shares. On this principle, the charges are certainly very much higher in London than in New York

The commission chargeable in London on a £1,000 transaction in shares of £20 each would be £5, which is still higher than New York

CHAPTER XXVII

STAMP DUTIES

In order to enable London to become the money market of the British Empire—a proud enough task for London—the 1 per cent. stamp duty imposed on all transfers of securities should be wholly removed, this concession to be conditional on the Stock Exchange Committee reducing the authorised commissions to a scale that would be competitive with the New York, Paris and Berlin markets.

The following figures show the cost of carrying through a typical £1000 share transaction on the London, New York, Paris and Berlin Stock Exchanges, as at September 1929 :

	London.	New York.		Paris.	Berlin.
	£ s. d. (In £1 shares.)	£ s. d. (In \$100 shares)	£ s. d. (In \$200 shares.)	£ s. d. (Parquet Cash.)	£ s. d. (Cash.)
Commission, etc.	12 10 0	2 10 0	1 5 0	3 0 0	3 0 0
Government Tax (stamps, etc.)	10 0 0	8 0	8 0	1 0 0	15 0
Total	£22 10 0	£2 18 0	£1 13 0	£4 0 0	£3 15 0

If Great Britain is to remain the central pivot of the British Empire, it must be prepared not only to consolidate the trade of the Empire, but to provide finance, on the lowest possible basis of cost, for the development of public works, railways and industrial enterprises in the countries constituting the Empire. Australia, for instance, desires to develop her railways and public utility companies. British industrial companies would

be glad to supply the materials. If commercial banking were a feature of the British banking system, this work could be undertaken to the advantage of both Australia and Great Britain. But the provision of finance and the cost of providing it—both as regards interest and stamp duties—are important factors.

It is here also that the system of preference duties would be of considerable advantage. It may be said that our trade with the Dominions and Colonies is not, at the present time, as important as our trade with foreign countries, but this is not the essential point. The real point is : To what extent could trade be developed within the Empire to mutual advantage if we had adequate commercial and financial banking systems ? And if the cost of providing capital, and transferring it, were reduced to the lowest cost ? Our haphazard, empirical methods are not only preventing us from consolidating the Empire, but they are causing us to lose it. In the eighteenth century we lost the American colonies ! We should now take care that we do not lose the Dominions, India and Egypt !

If a reform of the monetary system could be brought about on the lines suggested, and if the necessary economies in Government expenditure could be effected, the abolition of stamp duties in respect of all British interests is imperative for the following reasons :

1. It will remove the burden now imposed in providing finance for industrial and commercial enterprises established in the United Kingdom and throughout the Empire.

2. It will enable us to give facilities in the London market for British enterprises, in order to promote and consolidate trade within the Empire. With a system of preference duties, and the abolition of stamp duties, investment within the Empire would be more attractive than it is now, and it might encourage the realisation of

part of our foreign investment for this purpose. Under the new conditions outlined, investment within the Empire would be more secure than foreign investments are now.

The onerous stamp duties exacted at the time of creating the security in the case of bonds 'to bearer,' and in respect of every transfer in the case of registered stocks and shares, operate as a handicap in financing British enterprise. The fact that no stamp duties are exacted in the United States of America on the issue of securities affords an inducement to borrowers in the British Empire, particularly in the case of Canada, to arrange their finance in New York in preference to London. Such a procedure is undesirable having regard to the fact that to a considerable extent trade follows finance. The lower cost at which Canada has been able to borrow in New York has enabled the U.S.A. to penetrate Canada economically and financially.

The following comparative statement of sales of Canadian investments is illustrative and highly significant, particularly when the percentages are compared with the pre-war ratios. The figures have been supplied by the Dominions Securities Corporation of Canada (Toronto) by special request. In 1930, of the total investments sold, 46·51 per cent. were absorbed by the United States, and only 1·67 per cent. by Great Britain. In 1923, the corresponding figures were 42·24 per cent. and 1·00 per cent., whereas in 1913, the U.S.A. only absorbed 13·56 per cent., whilst Great Britain absorbed 74·24 per cent., and in 1910 the U.S.A. absorbed only 1·50 per cent., whilst Great Britain absorbed 81·50 per cent. There must be something radically wrong with the whole British financial system when it allows this state of affairs to continue, particularly as the London money market should be regarded primarily as the money market of the British Empire. If London were to be

regarded primarily as the money market of the British Empire, it would occupy a stronger position than it does at present as the money market of the world with its attendant risks.

Canada's industrial position is growing rapidly, and the annual output of its factories has been more than trebled since 1913. Likewise, its agricultural production has been considerably developed. All of which should have enabled Great Britain to invest more in Canada to-day than it was able to do in pre-war years. Trade should follow finance, and the consolidation of Empire trade and finance should be our first consideration.

Canadian Bond Sales

Percentages of Sales of Canadian Bonds, 1910–30 (Inclusive).

	1910	1913	1918	1922	1925	1928	1930
	%	%	%	%	%	%	%
Percentage placed in Canada . .	17·00	12·20	94·87	46·04	56·75	48·50	51·82
Percentage placed in United States .	1·50	13·56	4·70	53·52	42·24	47·96	46·51
Percentage placed in Great Britain .	81·50	74·24	0·43	0·44	1·00	3·54	1·67

Canadian Bond Sales

Comparative Statement, Three Years, 1928–30

—	—	Amount.	Taken by Canada.	Taken by U.S.A.	Taken by Great Britain.
Government	1930	$258,081,800	$118,408,800	$134,928,000	$4,735,000
"	1929	115,310,500	55,077,500	60,233,000	—
"	1928	78,876,333	24,578,000	44,565,000	9,733,333
Municipal	1930	113,211,556	91,269,556	21,942,000	—
"	1929	99,579,207	54,946,207	34,174,000	10,459,000
"	1928	29,909,525	29,209,525	700,000	—
Railway	1930	138,487,000	43,700,000	94,787,000	—
"	1929	198,000,000	82,285,500	108,997,500	6,717,000
"	1928	43,396,000	10,000,000	33,396,000	—
Public Utility	1930	143,120,500	67,328,000	70,302,500	5,490,000
"	1929	83,100,000	42,600,000	35,500,000	5,000,000
"	1928	60,140,000	27,246,500	28,000,000	4,893,500
Industrial and Miscellaneous	1930	52,190,000	44,640,000	5,950,000	1,600,000
	1929	132,026,500	94,226,500	32,300,000	5,500,000
	1928	211,303,000	114,403,000	96,500,000	400,000
Total	1930	705,090,856	365,346,356	327,909,500	11,835,000
"	1929	628,016,207	329,135,207	217,204,500	27,676,000
"	1928	423,624,858	205,437,025	203,161,000	15,026,833
Percentage taken	1930	100%	51·82%	46·51%	1·67%
" "	1929	100%	52·42%	43·18%	4·40%
" "	1928	100%	48·50%	47·96%	3·54%

NOTES.—(1) Government sales total does not include Treasury Notes of less than one year. These amounted to $37,500,000 in 1930.
(2) Issues of parishes or ecclesiastical institutions are listed under Industrial and Miscellaneous.

CHAPTER XXVIII

THE ECONOMIC POSITION IN FRANCE

THE real secret of France's success in draining gold away from London is to be found in the fact that her Central Bank—the Banque de France—has developed the system of commercial banking. The French Government, by the monetary law of June 23, 1928, prohibited the Banque de France from purchasing securities for its own account, and a glance at the figures which follow on pages 204 and 205 will show the consequential developments. During 1928, the franc was devaluated at almost one-fifth of its nominal gold parity. This meant that the nominal worth (in francs) of the gold holding of the Banque de France was multiplied by five. The surplus thus obtained was devoted to a partial cancellation of the Government's debt to the Banque. This explains the sudden drop in the total investments held by the Banque, and in view of the decree prohibiting the purchase of further investments the resources of the Banque have been employed in increasing rediscounts of commercial and foreign bills.[1] The increase of the gold stocks of the Banque de France has been employed

[1] In this connection the following extract from the report of the Royal Commission on Indian Currency and Finance is relevant:

'Dealing with the question of the propriety of including Government of India securities among the reserves, it is easy to appreciate that they form a far less desirable asset than commercial bills, for they lack that most useful quality of the latter to expand and contract the currency automatically in accordance with the needs of the country. In the case of Government securities, expansion and contraction depends entirely upon the will and judgment of the currency authority, and is therefore more liable to errors of judgment.'

in the correct scientific way, and the French people would naturally not look with favour on a reduction of their gold reserves for redistribution purposes. Commercial banking and financial banking in France are now separated into two institutions within the French banking system, and the currency in circulation is being gradually covered to the extent of 100 per cent. in real wealth. The ' Franc Standard ' has been adopted in France with advantageous results.

It should be noticed that since the devaluation of the gold reserves, in 1928, not only has the volume of foreign bills rediscounted or bought by the Banque de France increased, but also the cash in hand, *i.e.* the gold reserves. The increase in notes in circulation, and in Government deposits, is not without significance. The notes in circulation are at their highest point, yet there has been no inflation of commodity prices due to currency expansion. There cannot be if all expansions of currency are covered by wealth, and if the imports of gold are used in such a way as to prevent inflation in security values. Furthermore, the existence of the National Debt, which has to be financed by member bank credit, will of itself prevent an undue inflation of security values.

Many economists and financial writers are of the opinion that the imports of gold into France have brought about a rise in the cost of living in that country. If this were true, it would also have brought about an increase in wholesale prices. An examination of the wholesale and cost of living indices in France shows there has been a fall in the wholesale price index since April 1930, and a rise in the cost of living in the same period. See tables on page 206.

The rise in the cost of living in France since the early part of last summer is undoubtedly due to a decree of May 20, 1930, which increased the duties on the importation of foreign wheat from frs. 50 to frs. 80 per

BANQUE DE FRANCE

STATEMENT OF ASSETS AND LIABILITIES.

Liabilities.

End Dec.	Paid-up Capital.	Reserves.	Total Capital and Reserves.		Notes in Circulation.	
	Frs.	Frs.	Frs.	%[2]	Frs.	%[2]
1924	182,500,000	141,297,516	323,797,516	0·7	40,603,965,140	89·1
1925	182,500,000	186,759,951	369,259,951	0·7	49,992,606,215	88·3
1926	182,500,000	252,432,242	434,932,242	0·7	52,448,765,950	86·3
1927	182,500,000	318,276,969	500,776,969	0·7	56,300,610,250	80·6
1928	182,500,000	298,801,861	481,301,861	0·6	62,181,153,885	74·5
1929	182,500,000	298,801,861	481,301,861	0·5	67,769,335,400	75·1
1930[1]	182,500,000	298,802,000	481,302,000	—	78,937,582,000	—

—	Government Deposits.		Other Deposits.		Profit Balance.		Sundry Accounts.	
	Frs.	%[2]	Frs.	%[2]	Frs.	%[2]	Frs.	%[2]
1924	13,505,985	—	3,377,537,746	7·4	137,234,226	0·3	1,133,066,025	2·5
1925	63,574,354	0·1	4,707,726,945	8·8	108,838,843	0·2	1,344,054,249	2·4
1926	71,502,609	0·1	7,048,599,863	11·6	142,109,086	0·2	646,947,907	1·1
1927	107,172,483	0·2	11,571,784,820	16·6	91,592,205	0·1	1,275,422,651	1·8
1928	12,823,131,718	15·4	6,686,780,795	8·0	123,932,374	0·1	1,153,401,897	1·4
1929	12,167,896,767	13·5	7,925,986,579	8·8	309,015,351	0·3	1,581,783,094	1·8
1930[1]	12,154,052,000	—	10,076,019,000	—	——	—	2,237,282,000	—

[1] Provisional.

[2] Per cent. of total liabilities or assets.

Assets.

—	Cash in hand and at Branches.[1]		Investments.[2]		Bills Discounted.	
End Dec.	Frs.	%[3]	Frs.	%[3]	Frs.	%[3]
1924	6,420,488,874	14·1	27,951,866,891	61·3	5,251,060,170	11·5
1925	6,432,233,498	11·4	40,405,740,322	71·4	3,580,040,750	6·3
1926	7,521,119,239	12·4	41,575,024,198	68·4	4,544,267,955	7·5
1927	8,311,928,000	11·9	30,956,435,753	44·3	2,229,772,194	3·2
1928	45,470,618,746	54·5	9,242,980,750	11·1	23,780,228,348	28·5
1929	49,124,580,773	54·4	8,924,533,217	9·9	27,243,235,507	30·2
1930[4]	61,550,946,000	—	8,617,379,000	—	26,818,824,000	—

—	Advances.		Bank Premises, etc.		Sundry Accounts.		Total Assets.
	Frs.	%[3]	Frs.	%[3]	Frs.	%[3]	Frs.
1924	2,938,622,452	6·4	173,861,396	0·4	2,853,206,855	6·3	45,589,106,638
1925	2,548,062,818	4·5	188,648,374	0·3	3,431,334,795	6·1	56,586,060,557
1926	2,087,897,372	3·4	210,340,056	0·3	4,854,208,837	8·0	60,792,857,657
1927	2,230,178,141	3·2	217,298,842	0·3	25,901,746,448	37·1	69,847,359,378
1928	2,795,764,011	3·3	220,183,812	0·3	1,939,926,863	2·3	83,449,702,530
1929	3,268,721,583	3·6	220,425,477	0·3	1,453,818,495	1·6	90,235,319,052
1930[4]	3,534,998,000	—	220,522,000	—	3,143,568,000	—	—

[1] Including gold abroad : Frs. 1,864,320,908 ; 1927, 1926, 1925, 1924 and 1923.
[2] Includes Government's book debt to bank.
[3] Per cent. of total liabilities or assets.
[4] Provisional.

quintal. Now it is well known that as the cost of wheat is increased, the cost of feeding poultry—which affects the cost of production of eggs—and live stock is increased

FRENCH WHOLESALE PRICE INDEX.

(July 1914 = 100).
(45 Commodities.)

(July 1914 = 100).	No. of articles.	1928 average.	1929 average.	1930. April.	1930. Sept.	1930. Dec.
French commodities	29	619	635	595	595	565
Imported commodities	16	660	602	495	428	377
Food	20	587	584	523	538	525
Manufactures	25	675	658	592	534	475
Total	45	634	623	560	535	498
Gold equivalent	45	129	126	114	109	101

FRENCH AGRICULTURAL PRODUCTS.

Wholesale Prices at the End of the Month.

—	April 1929.	April 1930.	May 1930.	Dec. 1930.
	Frs.	Frs.	Frs	Frs.
Wheat (native), Paris, per 100 kgs.	154·00	126·37	135·00	172·00
Barley " " "	135·50	69·00	65·00	90·00
Oats " " "	134·50	70·87	68·75	75·00
Beef, second quality, per kg. net	8·70	9·90	10·50	10·60
Pork " " " " "	12·28	12·86	10·86	9·28
Retail Prices, Monthly Averages, Paris.				
Poultry per kg.	34·50	28·70	28·70	28·35
Eggs per dozen	9·56	8·23	8·11	14·03[1]
Milk per litre	1·75	1·70	1·51	1·80[1]
Bread per kg.	2·09	2·00	1·94	2·38
Potatoes (round white), per kg.	1·19	0·60	0·83	1·05

[1] An allowance must be made for the fact that winter prices for eggs and milk are always higher than they are in the summer.

proportionately. Thus it may be said that the increase in the cost of wheat has brought about the rise in the cost of living. Another factor tending to increase the cost of producing agricultural products in France has been

the National Insurance Law, under which it is obligatory on agricultural wage earners to insure for pensions and sickness benefits. The contribution for the agricultural worker is fixed at 2 per cent. on the wages received, and for sickness insurance at frs. 5 per month, the employer paying similar amounts.

For the purpose of comparing tendencies, the following prices for British agricultural products are shown :—

BRITISH AGRICULTURAL PRODUCTS.

Wholesale Prices at the End of the Month.

—	April 1929.		April 1930.		May 1930.		Dec. 1930.	
	s.	*d.*	*s.*	*d.*	*s.*	*d.*	*s.*	*d.*
Wheat (English Gazette average) per cwt.	9	10	9	0	8	7	6	0
Barley ,, ,, ,, ,, ,,	10	2	7	9	7	4	8	3
Oats ,, ,, ,, ,, ,,	9	9	6	8	6	7	5	6
Beef (English longsides) per 8 lbs.	5	8	6	0	5	10	5	4
Pork (English) ,, ,,	8	8	7	6	6	10	7	4
Retail Prices at the End of the Month.								
	d.		*d.*		*d.*		*d.*	
Eggs (fresh) each	1½		1½		1½		2½[1]	
Milk, per quart	5¾		5¾		5¾		6½[1]	
Bread, per 4 lbs.	9¼		8¾		8¾		7½	
Potatoes, per 7 lbs.	9½		4¼		4¼		6	

[1] An allowance must be made for the fact that winter prices for eggs and milk are always higher than they are in the summer.

The two foregoing measures were made effective in the early part of the summer of 1930, and it is a coincidence that the cost of living in France ceased to be influenced by the fall in wholesale prices from that time. It may be of interest to point out that the cost of living index was 626 in May 1929, and that it had fallen to 528 in April 1930. This fall coincided with the fall in the wholesale price index for the same period. It may therefore be safely assumed that the rise in the cost of living in France since April 1930 has not been due

to monetary causes, but to the increase in the cost of wheat and bread due to the increase in the import duty on wheat.

But the extraordinarily favourable economic position in France, as distinct from its splendid monetary and financial policies, is revealed in the following extract taken from the *Economist* (January 17, 1931). It is certainly relevant to the subject we are discussing.

The index of production for November (1913 = 100), covering nine of the principal industries, is 135, as compared with 136 in October, 137 in September, 144 during the period December 1929—May 1930 (the highest level recorded in French industrial annals), and a mean of 139 in 1929 and of 127 in 1928. The French general index figure for production in November is returned by the Statistique Générale as 6 per cent. above the 1928 level and 4 per cent. above that for 1929, as against United States, German and British figures showing declines respectively of 18, 19 and 12 per cent. below 1928 levels. Contrary to expectation, the detailed returns for November do not show a general decline. On the contrary, the figures for the motor-car and leather industries remain unchanged, while those for rubber goods show a rise of seven points and for extractive industries and textiles a rise of one point each. The continued improvement in the textile figure, which in August and September touched 20 per cent. below its 1913 level, or the lowest since the war, and recovered four points in October, is especially interesting. The textile industry, which for a few weeks in 1928 rose slightly above the pre-war level, is the only great French industry that has failed so far substantially to exceed its 1913 output. Engineering, metallurgy, building and paper fell back slightly during the month, but all, with the exception of metallurgy, are still well above their 1928 levels.[1]

The wholesale price index at the end of December is 498 (July 1914 = 100), against 504 for November and means of 623 in 1929 and 634 in 1928. The French figure for December corresponds to 101 gold, against Great Britain 112, Germany 120. The index for French products remained unchanged at 565, as

[1] It should be noted here in passing that the weight of taxation is very much heavier in England than in France, yet the producers in France, comparatively speaking, are in a much more favourable position as regards prices.—J. T. P.

in November, while that for imported commodities shows a further drop of 18 points to 377. In March 1929 the figure for domestic products was 647 and that for imported goods 665, while in the following month that for imported commodities was 23 points lower than that for native products. Since then the ratio between the two categories has been steadily widening. The reasons generally adduced are the excessive incidence of French taxation, and, latterly, the advent of the national insurance system, which is popularly alleged to be largely responsible for maintaining many prices here at a higher level than they are abroad.

The index figures of retail prices continue to rise, but it is a question whether this is not due to defective methods of calculation rather than to any real increase. So far as Paris is concerned, this figure is based on the selling prices of thirteen commodities only. This defect, which has often been pointed out here, is tacitly recognised to the extent that in its returns for the current month the Statistique Générale has dropped the ambiguous heading 'Retail Prices' and replaced it with the safer one of 'Index of the Prices of Thirteen Household Articles.'

When we bear in mind that the census of production for November in France is 135, as compared with an average of 139 for 1929 and of 127 for 1928, and that the wholesale price index represents 101 gold in France as against 112 for Great Britain and 120 for Germany, the French people have not much to complain of; they have been protected from the ravages brought about by the fall that has taken place in the general level of world prices. The gold prices mentioned are not strictly comparable, but they can be accepted as an indication of the trend of existing tendencies. The position disclosed affords a very striking illustration of what modern Central Banking practice, plus import duties, could do to restore prosperity to Great Britain. There are one or two obvious defects to be corrected if the system were made applicable to Great Britain, but no other economic system could do so much to remedy the difficulties she has to face.

In some quarters, the strength of the French gold position is attributable to the reparation payments that are being made to France. This is no doubt a contributory cause, but it is not the whole cause. The Federal Reserve Banks sterilise all imports of gold by allowing the ratios of gold to increase which are held against their deposits and currency note issues. In the case of the Banque de France, this method is not followed. On the contrary, imports of gold are allowed to increase deposits or currency, whichever may be preferred by the member banks of the French banking system, if they pay the gold to the Banque de France. All deposits held by the Banque de France are convertible into currency, and the main policy of the Banque is to ensure the convertibility of the currency into gold, which is the only sensible policy for a Central Bank to pursue.

It may then be asked why it is that imports of gold into France do not inflate the price levels. It is because there is in process of development in that country a division between commercial banking and financial banking, and it is with the former alone that the Banque de France is now wisely concerning itself. Under the re-discount facilities provided by the Banque de France, production must take place before credit is expanded ; hence prices are pre-determined, and imports of gold cannot influence them. But under the Bank of England system, credit cannot expand until imports of gold take place, or until the Bank buys securities. The latter form of credit expansion is of no practical value since no increase of the currency can take place ; it may be regarded as a form of inflation. Hence credit expansion must necessarily precede an expansion of production, and this must inevitably lead to an inflation of prices, since demand is made to precede supply and not supply precede demand, as in the case of the system employed by the Banque de France.

But to return to the question of reparation payments. After the Franco-Prussian war, and during the time Germany was in receipt of reparations payments from France, Germany went through a period of acute depression, which depression was attributed by economists to the receipt of reparation payments. To-day France is in receipt of reparation payments from Germany, yet France has the least unemployment in the world, whereas in Germany unemployment is very acute Therefore the theory of reparation payments cannot stand. A solution of the riddle is only to be found by closely examining the changing character of the assets and liabilities of the Banque de France.

Furthermore, the continued loss of gold by the Bank of England to France is not due to reparation payments *per se*, since Great Britain now receives from her debtors a little more than she is paying to the U.S.A. in discharge of her debt. The true explanation is that France and the U.S.A. prefer to take gold from Great Britain, so long as she can be induced to absorb or distribute the goods sent by the debtor countries in payment thereof, and for other purposes. This scheme works very well in the case of Great Britain, because, in view of the weight of taxation—accentuated by the return to the gold standard—which is largely shifted to costs of production, British producers are unable to compete with foreign imports on equitable terms. It will thus be seen that the orthodox free trade economists are, at the present time, the greatest friends possessed by France and the U.S.A.

Another form of criticism directed against the Central Reserve System of France and the U.S.A. is the number of recent failures of small banks in those countries. This form of criticism has nothing to do with the matter under discussion. It has to do with the systems of branch banking in those countries which are not nearly so strong as the one prevailing in England. Furthermore, the

failures of the banks in question were due to speculative financial transactions, and not to commercial ones, with which alone Central Banks are mainly concerned. The fact remains that the most prosperous Central Banks in the world to-day are the Banque de France and the Federal Reserve Banks, and if we bear in mind the relative positions of the Banque de France and the Bank of England five years ago, when the value of the franc was fluctuating violently, the point is not without significance. An extension of branch banking by the large American banks would considerably strengthen the financial system of banking in the U.S.A., and it would avoid the necessity for the formation and failure of so many small banks. There are, I believe, over 30,000 banks in the U.S.A.

If a Central Reserve System is able at all times to control the bankers' ratios, inflation and deflation can be automatically eliminated from the industrial and financial systems. Automatic stability is ensured, and it does not need the international control of gold, nor an open market policy, to effect this purpose. International co-operation for any other purpose is quite another matter.

CHAPTER XXIX

THE INTERNATIONAL POSITION

In certain quarters the view is held that, before we could reform our monetary system, we should have to pay due regard to the reactions which the contemplated reform might have on the international exchanges. If these reactions are likely to be against our national interests, I agree, but if they react against other nations, they are, for the time being, no concern of ours. The U.S.A. and France give no consideration to the effect which their economic policies may have on other nations : their own national interests are paramount. In international monetary affairs, the three dominating powers are Great Britain, the U.S.A., and France. Before international co-operation could come within the range of practical politics, it would be necessary for these three powers to agree to some form of concerted action.

But Great Britain, in view of her precarious position, and the fact that the U.S.A. and France between them control about half the world's gold supplies, could have very little say in any concerted action that might be agreed upon between these three countries. In monetary affairs Great Britain is a mere shadow of her former self, notwithstanding the confident assertions that are made to the contrary. We have only to look round the British Empire to observe her outstanding failures. Canada is not on a proper gold exchange standard, Australia is in unnecessary difficulties, and India is suffering from acute deflation because of the imperfect gold exchange

standard established by us in that country. Is Great Britain, at the present time, in a position to help either of the Dominions or India? It would be difficult for anyone to affirm that she is, since it is obvious she is finding it difficult to cope with her own monetary and financial affairs. How then can she offer, with any hope of performing effective service, to join the U.S.A. and France in any concerted action designed to bring about an economic use of gold in the currency systems of the world?

Before concerted action with the U.S.A. and France is possible, it would be necessary for Great Britain to recover her authority and prestige. She has undoubtedly a certain amount of authority at the present time, but this is merely due to the prestige she formerly enjoyed, and the experience and knowledge acquired as a result of it. The integrity of London bankers is also another great asset. The only way by which Great Britain may recover her former status in world affairs is for her to adopt an economic system somewhat akin to those employed by the U.S.A. and France. The defects that exist within those systems are known, and they can be easily avoided.

When Great Britain attains this desired position it will open the way for the standardisation and perfection of the monetary systems employed by Great Britain, the U.S.A. and France, which could then serve as models for adoption by the other nations of the world. Until that event happens, it is impossible for Great Britain, with any degree of sincerity, to seek concerted action with a view to adjusting the monetary affairs of the world. Great Britain has enough to do to put her own national affairs, and those of the Dominions and India, in order. And I venture to suggest that the completion of this task alone would go far to bring about a recovery in the general level of world prices.

The natural questions that arise from the argument as

developed are these : Why then pretend that we are as we were? Why place ourselves in the undignified position of going cap in hand to the U.S.A., to France, and to Geneva, pretending that we are out for concerted action, when in reality we are seeking for concessions that will benefit ourselves. Our friends observe it and simply smile indulgently at us. Charity still begins at home. In saying this I am not urging the pursuit of a selfish nationalism ; I am simply saying that before we can undertake to advance the welfare of nations in an international sense, we must possess the liquid wealth and gold reserves essential for the task.

In conclusion, I should like to quote the views of the late Sir Charles Walston, with which I agree. I make no apology for the extensive quotation, since it bears intimately on the problem at issue :

Ultimately a new conception of nationality and internationality will be ushered in, in which loyalty to the narrower relations will in no way prevent loyalty to the wider. It will be an era of patriotic internationalism.

Let me at once anticipate and say to you in simple words that, at least as regards the civilised and democratic States of the West, to which practically all of us here belong, nationality means the corporate unity of the free citizens of a State, whether single and self-contained, or united into a wider whole as a confederation, a federation or an empire, on the grounds of political, legal, social, moral and intellectual unity of the people of such States and their common ideals.

Internationality for us thus means the relationship, tending towards closer union and organisation, of these several States as units, while retaining their complete independence and 'sovereignty,' on the ground of the positive moral agreement between them all, however different the separate manifestations in the character of each one may be. These physical and moral properties, towards which they all strive, are, moreover, directly furthered in their common interest for the good of humanity as a whole.

With all tolerance towards other nationalities let us, however, never forget that our own nationality, which gives coherence and

solidarity, independence and security to the State of which we are citizens, should be one and undivided; that by word and by deed and by our whole lives we should confirm and strengthen this unity of the political and moral corporateness of our own State. This is a primary and essential need and duty.

CHAPTER XXX

CONCLUSION

FROM the arguments which I have so far developed it will be seen that Great Britain is suffering from the following defects in her economic mechanism:

(1) A high costs level due to the weight of taxation, which is the highest in the world, and which taxation is largely shifted to costs of production. To overcome this difficulty it is essential that a larger volume of production should be done within the country, and that there should be a scientific redistribution of the weight of taxation, with a view to neutralising its effect upon costs.

(2) An insufficiency of credit originating in production and terminating in consumption. At present too much credit originates in Government and other securities, which credit cannot be terminated in the securities. It is not suggested that the latter form of credit should be restricted, but merely that the producers should have the same access to credit as if Government and other securities did not exist.

(3) Items (1) and (2) suggest a widening of the basis of credit on sound lines, and that where any inflation exists it shall be removed as soon as possible, to facilitate which, a complete revision of monetary policy, as practised by the Bank of England, should take place.

Items (1), (2) and (3) suggest that the issue of credits against self-liquidating wealth products should be completely divorced from credits issued against securities, as

is the case under the Federal Reserve System. The Member Banks in the U.S.A. issue security credits, whilst the Federal Reserve Banks re-discount eligible bills of exchange which are clearly defined on p. 112. In this way industrial and commercial concerns have direct access to the Federal Reserve System through the Member Banks, which access is not interfered with by any excess of credit issued by the Member Banks against securities, or by any excess of Stock Exchange speculation.

As I have indicated, it is not suggested that there should be any curtailment of credit facilities to those who require advances against collateral securities ; on the contrary, the full facilities must be maintained. But as the implications of the quantity theory of money, in so far as they relate to production, can be neutralised by productive power under Central Reserve Banking practice (see Chapter XVIII), it suggests that credits issued against wealth products and securities should be divided into two separate and distinct departments.[1]

As we increase the volume of production, and if credit is increased proportionately with it, prices will fall, because prices are controlled by the quantity of production and not by money. But if we increase the volume of bank credit against securities, the prices of these will rise in proportion to the quantity of bank credit issued ; and so long as speculation in natural materials is prohibited, no harm can be done. If investors wish to invest in securities, and be allowed to exercise their judgment

1 I have elaborated and perfected this part of my thesis in the new Chapters XIX, XX and XXI, which should be read again at this stage. Here I show that commercial banking must be separated from financial banking, and that the ratio at which banks may be permitted to expand financial credits should not exceed nine to one. In case of emergency, the Central Bank should have power to lower the ratio in order to avoid manipulating its re-discount rate, which not only is not as effective as controlling the ratio, but it unnecessarily penalises the industry and trade of the country. This part of my thesis is in essence the basis of 'The Dual System of Stabilisation.'

against one another, let them do so. The people have a perfect right to speculate with their own money if they so wish it, so long as it does not interfere in any way with the full credit facilities that should be available to industry and trade.

Dr. Anderson mentions in *Lloyds Bank Monthly Review*, May 1930:

> that Central Banks have not maintained the gold standard by regulating their supplies of means of payment with reference to the level of commodity prices. They have done a much simpler thing. They have redeemed their currency on demand in gold! They have not worked *indirectly* from paper money *through commodity prices* to gold in the effort to fix the relation of gold and paper money. They have worked *directly*, meeting their legal obligation to redeem their promises to pay on demand, and letting commodity prices take care of themselves.

This is not quite true, although it should be. The Central Banks in London and New York have open market policies; but the effects they produce vary, because the mechanism under which they each operate is different. The Bank of England's policy is to vary the implications of the quantity theory of money as circumstances require. In recent years, the Bank of England has favoured a policy of deflation in order to approximate internal prices with world prices. This is no part of the business of the Bank of England. On the other hand, the regulated mechanism under which the Federal Reserve System operates prevents it from interfering with the U.S.A. internal price level, although it may attempt with varying degrees of success to control an abnormal speculative position. In other words, its sole power of interference is to make money cheap or dear as circumstances require. Therefore, as matters now stand, Dr. Anderson's proposition has to be accepted with qualification.

The sole business of a Central Bank, after its mechanism and policy have been determined upon and

regulated by the State, is to provide the producers with full re-discount facilities for commercial bills of exchange, provided they are endorsed by a bank, and provided they embody the new legal implications required as to the use of money, and are drawn with recourse against the capital assets of the drawers of the bills, and 'to meet its legal obligation to redeem its promises to pay on demand,' and to let commodity prices take care of themselves. A Central Reserve Bank should be the parent of a credit policy, based on wealth production, and not of a banking policy. But the basis of a sound banking policy should be the co-operation of the joint stock banks with the Central Reserve Bank so as to ensure the maintenance of sound banking principles.

I agree with the concluding paragraph of Dr. Anderson's article, above mentioned, and, as it touches on my general theme, I quote it here :

> The fundamental solution of the problem of a comparative shortage of gold is to be found in increasing the mobility and the liquidity of goods, through less restricted international trade. When nations interpose serious obstacles to the receipt of goods from one another, a great deal of the export trade is handled on the basis of long credits, which either make slow loans in banks, or else require the exporting country to take foreign bonds. These credits must grow from year to year to provide for new exports, and to provide for interest on previous credits. The country which has an excess of gold can expand bank credit for a time in such a way as to take care of this. Exporting countries which are short of gold find increasing difficulties in doing it. In any case, it is an impossible basis for permanently satisfactory export trade. When, however, goods can move with adequate freedom from country to country, and when exports can be paid for with imports, a very different situation is presented. Short-time, self-liquidating credits, largely on an acceptance basis, can then take care of a great volume of export and import business, and the world's supply of gold is abundantly adequate for that. We can economise gold by increasing the mobility and liquidity of goods.

Government Securities acknowledge the indebtedness

of the nation to those from whom it has borrowed money. Instead of issuing currency notes in acknowledgment, which would cause inflation, the Government creates long-term loans payable at certain fixed dates in the future, when the holders of the securities are entitled to full repayment in money. But if the holders of Government Securities are meanwhile entitled to pledge them with their bankers against temporary or fixed advances, then, if it limits the volume of credit available to production, the issue of credit against Government IOU's is not being avoided.

Money = Currency and Credit. If the Government decides to inflate the currency uncovered by wealth products it will bring about a rise of prices. If it decides to issue securities in lieu thereof it brings about deflation, because the holders thereof, and not the producers, have the largest pull on the available credit resources. Whatever the method of procedure employed under the gold standard as practised by the Bank of England, Government Securities must always monopolise the credit structure.

The technical reason for this is as follows: when the large volume of government securities was issued during the War, special arrangements were necessary. At the request of the government, the banks were asked to provide credit to all subscribers of war loans if they were able to put up a small margin, which, I think, was 10%. The government made an appeal to the patriotism of subscribers and bankers alike to increase their subscriptions and credit resources for war loans to the maximum possible. The banks provided the additional credit required, and themselves subscribed substantially to the war loans—to do which they no doubt arranged to work on lower cash ratios—and all that was created in this way was duly supplied to the government and ultimately blown into the air.

This credit, in effect, became loans to the government, and was created because there was an insufficiency of income out of which subscriptions to war loans could be met. All the watered credit thus created has been carried forward from year to year, and although many of the old loans have been paid off through the medium of renewal loans and cash subscriptions to new loans, nevertheless the watered credit still remains. The only result of the various operations that have taken place in connection with subsequent issues of government securities has been to transfer the old contractual obligations from the old securities to the new ones. Therefore, the original credit which was extended to the old holders of government securities has practically resolved itself into a huge loan to the government, which has to be carried over from year to year until it can be discharged by subscribers out of income. There will, of course, be small exceptions here and there, as there is in every rule, but in the main the argument holds good.

It is, therefore, a moral obligation on our part to continue to extend credit to the holders of government securities, but do not let it be said that the credit that has already been blown into the air is finding its way into production. One might as well say that apples can be made into cheese. It should also be borne in mind that the nominal national debt to-day is approximately the same as it was in 1919, so that there has been no material change in the position carried forward.

The necessary legislation to be enacted in order to convert the Bank of England into a Central Reserve Bank should contain the following provisions.[1] I am indebted to E. A. Goldenweiser's book, 'Federal Reserve System in Operation,' for some of the information used.

(*a*) The title of the Act should conform to the full

[1] See also Chapter III and notes to Chapters XX and XIII.

title of the Federal Reserve Act approved December 23, 1931, which reads as follows :

> An Act to provide for the establishment of Federal Reserve Banks, to furnish an elastic currency, to afford means of re-discounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.

According to E. A. Goldenweiser 'this title indicates that next to the creation of elastic currency the framers of the Act considered "that to afford means of re-discounting commercial paper" was the most important purpose of the Act.'

(*b*) 'The provisions of the Federal Reserve Act "indicate the fundamental nature of the discount activity of Federal Reserve Banks. These discounts must originate in a demand in the commercial market for purposes of production and distribution. *The Reserve Banks thus are intended to create only circulating credit*, and not credit to be used for capital purposes or for speculation. The liquid nature of the discounts is further assured by the requirement that the paper must mature within 90 days."'[1] The italics are mine.

(*c*) A member bank may be permitted to extend credit by way of discount to a trader for the purpose of carrying merchandise in store, the disposal of which may take six to nine months, but it shall be re-discountable at the Central Bank any time during the last three months of its maturity. This means that the member bank would have to carry the discount in its own portfolio during the first three or six months, whichever the case may be.

(*d*) With regard to discounts for purely agricultural purposes, as agricultural turnover is much slower than industrial turnover, the date of maturity of eligible bills should be extended to six or nine months at the

[1] Goldenweiser.

discretion of the member banks from the usual 90 days. No limit to be placed on the amount of bills discountable provided their maturity date does not exceed six months. But in the case of bills having a maturity date in excess of six months, the amount discounted should not exceed 15 per cent. of the total assets of the Bank. Agricultural paper having a maturity date of nine months offers no greater facilities to agriculture than three months paper offers to commerce and industry. Agricultural paper, within the meaning of Section VI Federal Reserve Act, is defined as 'a negotiable note, draft, or bill of exchange issued or drawn, or the proceeds of which have been or are to be used, for agricultural purposes, including the production of agricultural products, the marketing of agricultural products by the growers thereof, or the carrying of agricultural products by the growers thereof pending orderly marketing, and the breeding, raising, fattening, or marketing of livestock, and which has a maturity at the time of discount of not more than nine months, exclusive of days of grace.'

(*e*) All the joint stock banks and private banks, which accept deposits and make advances, should be obliged to become members of the Central Reserve Bank, and submit to the regulations of the Central Reserve Act.

(*f*) Provision should be made to prohibit the Central Reserve Bank from trading for profit, and dividends should be limited to 6 per cent. It should in no way compete with the member banks. The capital of the Bank should be subscribed as to 50 per cent. by the member banks and 50 per cent. by the general public.

(*g*) The Chairman and two other directors of the Bank should be appointed by the Government, and the remaining six directors by the members of the Bank, three of whom should represent commerce and industry

and three representing banking. Branches of the bank should be established at Manchester, Glasgow, and Belfast.

(*h*) The Central Reserve Act should provide, *inter alia*, that the ratio of deposits to cash held, in hand and at the Central Reserve Bank, by the member banks, should not exceed 9 to 1, and that the Central Reserve Bank should have power to reduce this ratio ½ per cent. at a time in order to promote stability, or to check undue speculation. The Central Reserve Bank should be prohibited from manipulating the re-discount rate for the purpose of checking speculation in the financial system of banking, which, as experience has shown, is ineffective.

(*i*) The Central Reserve Bank should be prohibited from purchasing securities or bills for its own account except perhaps for the investment of its own reserves. A more preferable course would be for the Bank to invest its reserves in foreign currencies, or short-dated dollar and franc securities which can be converted into gold on demand.

(*j*) With regard to the securities held by the Bank of England at the present time against the fiduciary issue, these should be sold gradually, as and when favourable opportunities occur, until they are reduced to a sum not exceeding £25,000,000, which sum should be sufficient to cover currency in circulation not likely to be presented for payment in cases of emergency. The securities sold should be replaced by eligible re-discounts.

(*k*) It should be compulsory on all member banks to re-discount all eligible commercial bills with the Central Bank.

(*l*) The Central Reserve Bank should not be permitted to lend money to member banks against securities, Government or otherwise. It should strictly confine itself to re-discounting eligible commercial bills and

ensuring the convertibility of the currency. In this connection, it will be of interest if I add the following by E. A. Goldenweiser, with which I agree :

> In every reserve bank there is a loan committee, consisting of some of the higher officers, which passes upon each piece of paper presented to the bank for discount. This committee must first ascertain whether the paper is eligible under the law and regulations of the Federal Reserve Board, and second, whether it is acceptable, *i.e.* whether the credit back of it is good ; whether the particular member bank which presents it is entitled to more credit, etc. This distinction between eligibility and acceptability of paper presented for discount to the Federal Reserve Bank is important and is not always appreciated.
>
> Eligibility is a matter of law and regulation. In order to be eligible paper must comply with definite standards as to the transactions which gave it origin and as to maturity, while its acceptability is entirely independent of these matters and rests on the credit standing of the signers, the availability of funds, the question of whether the particular member bank has exhausted its legitimate quota of credit, whether experience has shown that the bank is using Federal Reserve Bank accommodation for improper or undesirable purposes, and a number of other considerations which are not definitely formulated but are entirely within the discretion of each loan committee and board of directors, subject to the legal limitation that the Federal Reserve Bank shall grant accommodation to each member bank with ' due regard to the rights of other member banks ' and with a view to ' accommodating commerce and business.'

Monetary mechanism should be designed in such a way that producers should have the same access to credit as if Government and other securities did not exist. National debts, and other forms of internal debts, are incurred on the assumption that the potential productive power of the country, and its income—which exist at the time the debts are incurred—will always remain the same, and possibly increase. But if the monetary mechanism is such that the creation of debts ultimately diminishes the nation's capacity to produce and consume, then, indeed, it becomes a paradox.

The exporting trades, and, with two or three exceptions, the world in general, are suffering from an inefficient use of the world's reserves of gold for monetary purposes, in addition to which there is a mal-distribution of reserves. There has been a vast increase of Government debts throughout the world, and too much of the credit created on a gold basis is being absorbed in financing such debts, which, in turn, has increased the price of money, thereby increasing the general weight of taxation.

The inefficient use and mal-distribution of the world's gold reserves have brought about severe deflation and a steady general decline in the level of world prices, with a consequent general shortening of production and consumers' purchasing power. But this deflation has not affected those countries blessed with modern Central Banking practice, such as the U.S.A., France and South Africa, to anything like the extent it has done those countries not blessed with modern Central Banking institutions—the reason being that in the U.S.A., France and South Africa the 'Dual System of Stabilisation' is largely, if not wholly, in operation, without those countries being fully aware of the fact. And notwithstanding the general fall in world prices, France and the U.S.A. have, in recent years, paid off vast sums of public debt, and have effected substantial remissions of taxation. In Great Britain, in particular, the reverse has occurred.

A further aggravation of the world's difficulties, particularly in Eastern countries, has been the fall in the value of silver. Silver is being gradually demonetised, which is increasing the available supplies in the world markets. The price of silver has fallen from 89½*d.*—its highest point in 1919—to 12½*d.*, which is its present price. The collapse may be said to be due to world causes, the most notable of which was

the breakdown of European currencies, which led to the melting down of silver coins and silver plate, and the sale of the metal.

The main trouble in India and China, particularly in China, is clearly one of deflation, brought about by a contraction of the basis of credit caused by the severe fall in the value of silver. Owing to the absence of adequate banking facilities—added to which, a lack of use of the facilities when available—the Indian and Chinese people have been accustomed to hoard their wealth in silver metal, or in silver ornaments, and to obtain cash by a realisation of the metal or the ornaments. In this way these people have lost a great deal of the realisable value of their wealth, which has caused a shortening of their purchasing power. It is one more confirmation of the fact that the nations would be very unwise indeed if they continued to rely exclusively upon the precious metals for the advancement of their welfare and prosperity. It has been well and truly said that money—and by this is meant metallic money—is the root of all evil.

The recommendations of the Royal Commission on Indian Finance and Currency (1926), and their acceptance by the Government of India, mark a decided step forward in the development of the monetary policy of India. Indian commercial feeling is still very suspicious of what it regards as the manipulation of its currency and economic well-being in favour of England, and it is extremely regrettable that this feeling should not only have been allowed to arise, but to develop. The more prosperous India can become industrially and commercially, the more will it benefit those industries that do trade with India. The more prosperous the world becomes generally, the more prosperous will each nation become in particular.

The more one views the economic history of India,

the more is one impressed by the fact that the economic prosperity of India has been held back, because of the fear that if she had been given a modern Central Reserve Bank it might have increased the demand for gold. Even although the Royal Commission recommended the establishment of such a bank in India, a Bill making this effective is not likely to pass into law till the year 1933.

I am not surprised to hear the reports that a crisis exists in commercial and financial circles in Hong-Kong, Shanghai and Japan. The sudden fall in the purchasing power of silver is a very serious matter to Chinese merchants and traders having commitments in gold. On all purchases of foreign goods Chinese merchants have to pay 20 per cent. more than they would have had to do six months ago. Furthermore, on all new engagements entered into at the present time merchants of China run the risk of the price of silver rising again, and this reaction would involve them in further losses. Lack of stability in the par exchange must at all times involve a diminution of trade.

Silk and tea are the Chinese staple exports, but owing to the depressed condition of the world markets, China can hardly expect to derive much advantage from the cheaper tael. Foreigners may be able to derive an advantage from their purchases in China, but such advantages can only be gained by the impoverishment of the Chinese merchants, traders and people. In the long run, world trade with China is bound to suffer.

In view of the currency difficulties, the Chinese Government is most anxious to anchor her whole currency system to gold, and with this end in view she appointed a foreign commission, headed by the distinguished American economist, Professor Kemmerer, the well-known authority on currency questions. This commission left the United States to investigate China's currency problems towards the end of 1928, and its

report will shortly be issued. I understand that it proposes to recommend the establishment of a Central Reserve Bank for China based on the Federal Reserve System. But it is now being stated in authoritative quarters in the City of London that China has not the resources for any big currency scheme, nor has she the necessary political stability. It is further said—and there seems to be complete agreement about it—that the chances of China changing over to modern Central Banking practice are exceedingly small, and that the Central Banking authorities of the West are scarcely likely to favour such a move at the present time. I can quite appreciate these views if it involves China entering the London free gold market with a view to acquiring gold for the purpose of creating gold reserves. This would be a necessary preliminary before the proposed Central Reserve Bank for China could be brought into existence.

The mooted transformation of the Chinese currency system into a system that accords with modern Central Banking practice will be a difficult matter for the Chinese National Government to bring to reality without the good will and co-operation of the Western Powers. If the gold standard system has such excellent virtues, it is surely essential that the system should be extended throughout the world in the shortest possible space of time.

The exporting trades of Great Britain are suffering, like the people of China, from the fact that a measure of value convertible into gold does not exist in China. The par of exchange should be the face value of the currency unit of one country, expressed in terms of the currency of another country, which uses gold bullion for convertibility purposes, and this definition holds good even now. The value of a national currency unit is taken to depend on the quantity of purchasing power which it

commands—at the general level of world prices—over the mass of home-produced commodities, including gold bullion, for which latter purpose adequate gold reserves should be held. The par of exchange should accordingly tell us how much we are entitled to receive in commodities and/or gold bullion from other countries in exchange for their currency. In so far as the international exchanges go, therefore, the mint par of exchange should, in future, simply mean that the holders of a national currency will have the right of converting its face value into gold bullion at a given weight and fineness, established by the law of that country, in the event of any depreciation having taken place in its purchasing power value.

But the question that now arises is, If the gold standard has all the virtues which are claimed for it, why should the League of Nations not be urged to induce, and assist, China to adopt it? If there is not enough gold to go round, it is quite clear that the exclusive gold basis cannot be sustained. If the quantity of gold could be redistributed so that every nation obtained a fair share, an exclusive gold basis would mean severe deflation, and the starving down of the populations to a point at which they could all live on the quantity of money (money = currency and credit) that could be created on the gold so redistributed.

The definite fact is that the total quantity of gold available in the world is not sufficient to meet the currency needs of each country, if the gold is to be used as the exclusive basis of the quantity of money, or even to sustain a ratio system of 40 per cent. gold to 60 per cent. in fine commercial bills. If it is to be used exclusively as an international means of payment—*i.e.* to sustain a real gold exchange, which is its proper function—then there is a sufficient volume to meet all legitimate requirements, and such questions as the

limitation of populations need not arise for consideration.

In order that China may recover its prosperity and political stability, and the cotton trade recover its export trade to China, it is essential that a paper token currency should be adopted in China as the measure of value, which should be convertible into gold ; it being a condition, however, that all issues of such currency notes for internal purposes should be covered to the full extent of 100 per cent. in fine commercial bank bills and the gold reserves, so that a full standard of value may be maintained. This would reduce world trade with China to the good old barter system, and restore that sound old economic principle which is so essential for the prosperity and welfare of mankind, that exports should pay for imports.

By an edict (January 15, 1920) of the Chinese Government, Nanking, issued to the Chinese Customs authorities by the Finance Minister, duties on imports from abroad are in future to be collected on a gold basis. The Haikwan tael is to be no longer used as the unit of calculation and is to be replaced by a new gold unit. This new unit will be equal to 60·1866 centigrammes of fine gold, equivalent to 19·7265 pence sterling. This important change has resulted from the decline in the value of silver, in consequence of which the value of the Chinese Customs receipts had greatly depreciated in terms of gold. This point should be noted by exporters of merchandise to China, since it will increase internal prices in China, and thus impoverish still further the purchasing power of the people of China.

From the foregoing remarks it will be seen that the assertion made by several chairmen of joint stock banks that the existing monetary system is able to provide all the credit facilities that are required, does not touch the fundamental issue involved, namely, the creation and distribution of wealth. I have shown that we cannot

redistribute, or distribute, wealth through taxation. The one and only vehicle through which this may be done successfully is the pound note, secured on the mass of commodities. The pound note is only useful for what it will buy, namely, butter, eggs, boots and shoes, etc., and the more we create of these wealth products ourselves, the more can we divide them. It may be taken for granted that foreign nations are not interested in doing this work for us, if we cannot do it for ourselves. And the more prosperous we become as a nation the more prosperous will the world become in general. This sound maxim will apply to all individual nations.

The bankers are right when they say that no sound proposition is ever refused credit facilities. But the number of sound propositions in the market-place to-day is extremely limited, and they are limited because of the defects in the monetary system. And when they are brought before the bankers for consideration, they will naturally consider them favourably, but the facilities they may provide will be at the expense of their weaker accounts. All concerned must bear in mind that the banks are always out to improve the quality of their collateral, and that they are working to definite ratios beyond which they cannot expand, unless there be an import of gold, which would mean an increase of cash to the banks, and thus an increase of lending power.

It may be said that the increase of costs of production in this country is a non-monetary cause. It would be difficult to prove that monetary policy directly increased costs of production except through its limitations, which restrict production. But it is easy to prove that its limitations are the primary cause of the excess of taxation over and above what might have been found necessary as a consequence of the War. So that monetary policy may be said to induce a non-monetary cause, namely, taxation, to increase costs of production to such an extent

that no conceivable increase of industrial efficiency could wholly overcome it, particularly in view of the fall in the general level of world prices.

Some economists are still sceptical and critical as to the value or virtue of a falling price level freed from monetary control. They contend that it means a form of deflation which is not true, and that the debt holders would still receive more goods in satisfaction of their interest and capital repayment. But what they overlook is that the debt and the interest charges exist, and the fact that all debts will have to be paid off should not exclude the establishment of a sound economic policy. In any event, the existing policy of deflation would always assure to the debt holders more wealth than they are entitled to receive. They will continue to receive more and more, and the economists, try as they will, cannot prevent it. Furthermore, it is immaterial to the producers what the amount of goods may be which they can deliver in exchange for consumers' money, so long as they can earn a profit on the capital employed in their businesses. In the acute process of deflation which now exists, it is impossible for the producers, generally speaking, to earn profits. They are lucky indeed if they earn their overhead expenses.

A falling price level induced by deflation causes a shrinkage of production, financial losses, a loss of enterprise, and unemployment. But, be it noted, the banks continue to make handsome profits through it all. A falling price level, due to an expansion of production and a proportionate increase in the quantity of money, promotes prosperity, enterprise, rising wages and employment, and a cheapening of the price of money; subject, of course, to the stabilisation of the price of cereals, which stabilisation is the sheet anchor of all prosperity. All true purchasing power originates with the soil and in no other way.

The main object to be achieved by inducing a falling price level in an expanding production is not only to create a sound basis for an expansion of credit, but to create cheap money ; and this is a key point which many economists overlook. Cheap money could never be brought about under existing mechanism, in view of the extent of the national debt, unless production was considerably curtailed, with a consequential contraction in the demand for credit. It is generally admitted that if there were a keen demand for credit in consequence of increased industrial activity, the price of it would rise. It must necessarily do so in view of the pull which the holders of Government securities have over the available credit resources. It would be possible, of course, for Central Banks throughout the world to agree to cheapen the price of money with a view to checking the fall in the general level of world prices, but an artificial expedient of this kind can have no value. Production and consumption cannot be increased through manipulating bank rates, and it is about time this obsolete idea was scrapped.

I do not agree with the economists who argue that wages, commodities and effort should be stabilised, nationally or internationally. Mankind should be given the utmost freedom in its strive upwards. Man has not yet had his economic freedom, and it is impossible to say at this stage of human existence to what heights he could attain with the aid of our chemists and scientists. 'Upwards life striveth to build itself with columns and stairs : into remote distances it longeth to gaze—*therefore* it needeth height !' It is the business of the economist to observe general tendencies and gather them up into concepts. It is not his business to regulate man's life with theories of which the world has had no experience.

As I have indicated in the general theme of the work,

taxation is an abomination, and it should be reduced to the lowest limits possible in the shortest space of time. Likewise, Government debt should be discharged at the earliest possible moment, but not through an increase of taxation. The only sound and effective way by which we may redeem debt is through Budget surpluses, and these in turn can only be induced through a sound economic mechanism. We cannot divide until we can produce, and the more we can produce, the more we can divide. The evil effects which some economists fear from an expansion of currency based on proper cover are the result of an excess of imagination. Let them ponder over the nightmare of inflation which already exists in Government finance and taxation, the social services, and the whole credit system, and after a little careful reflection on these subjects they might see the wisdom of creating and introducing a great deal more wealth into the whole of the credit structure, so as to give it a great deal more backing. In the end, we cannot divorce Government credit from banking credit. If one goes, the other must go too.

Fundamentally, Great Britain must employ its population in production, first for home requirements, and secondly for export. Consequently, the nation's industrial and monetary policy should be co-ordinated. It will be admitted that we are far too industrialised for any change in this vital tendency. The creation and maintenance of economic employment is essential in order that the weight of taxation may be carried with less difficulty than it is at present.

National taxation, both direct and indirect, is largely shifted to costs of production, which are thereby made unduly high. Even where it is not so shifted it reduces savings, and thus causes a reduction of effective demand for commodities. Costs of production are therefore national costs, and are not international costs, or even

Empire costs. Consequently, national regulations are required which will ensure that all who share in the trade of the home market shall contribute their due proportion of the weight of national taxation. National monetary policy should be designed in such a way as to make the nation's industrial policy effective.

So long as the existing fiscal policy of the country is maintained a national monetary policy is not possible. A national monetary policy is desirable if industry is to be modernised and sustained. Any increase in the quantity of work brought about must be sustained by a proportionate increase in the quantity of money, so that the producers may control the costs levels of the goods they produce. In future price and value should mean one and the same thing. At present the monetary system controls the price level, but, as it is a wrong principle, a change is necessary in the interest of the producers.

To continue to consume, directly or indirectly, foreign goods which do not contribute their fair proportion of the revenue to the country, *i.e.* taxation, only tends to throw an additional burden on the production that remains to be done within the country. The handicap under which British industry operates is thus aggravated. The business of importing foreign goods should no longer be permitted to continue as a sheltered trade, and at the expense of British producers.

Cheap sound money (money = currency and credit) can only be brought about by an increase of production. Pound notes based on bills of exchange backed by wealth products are the soundest of all currency, and if the notes are covered to the extent of 100 per cent. by wealth products and the gold reserves, credit will be cheapened. Gold is a wealth product ; but it should not, by reason of its existence, limit the production of other wealth products. Production should be limited by the extent

of effective demand only, such demand being determined by human needs and not by gold.

The basis of all credit should be the barter system of goods and services, *i.e.* a balanced supply and demand. But there should be no law of supply and demand based on inflation and deflation. Established economic principles are fundamentally true, but their successful application depends upon the mechanism under which they are operated. The gold reserves of the country should be used with other commodities as the basis of the quantity of money, but reserved exclusively for the adjustment of adverse balances of trade, and as an international means of payment. The gold reserves should also belong to the country exclusively, and should not be held subject to export through the conversion of foreign balances now on loan in the London money market, which export causes us to lose our national industrial independence through contracting the volume of internal credit.

Modern tendencies in production involve floating credits, whether in respect of machinery or stocks, on a scale never contemplated before. To restrict that credit by periodical dear money due to altogether irrelevant circumstances—such as exports of gold, or inflationary tendencies—amounts to a restriction of economic employment, and an inability to produce to an efficient load factor, with an inevitable reaction on the real wage situation, employment, export, and the prosperity of the community as a whole.

To continue to use, directly or indirectly, British credit to finance the sale or purchase of the produce of other countries through the London money market—the facilities of which are not open to British producers—must displace the actual products of British labour, which, in the long run, will delay or render impossible the modernisation of plant and methods upon which the British export trade can be increased.

The development of a British Empire economic unit is desirable. But, as costs of production are national costs, and are not international costs, or even Empire costs, Empire Free Trade is impracticable. Great Britain cannot enter into outside commitments until her own balance sheet is first of all put in order so that the extent of her liabilities may be ascertained. It is not desirable that the attention of the public should be focused on any external issue, because this may lead to a belief that it is fundamental. The real cure for industrial depression and unemployment must be national in scope. This is the fundamental issue which the British people must keep ever before them. A British Empire Preference System is practicable, but its development should take place in its proper order.

In view of the considerable expansion of trade that has taken place in recent years within the British Empire, it is evident that a further extension of trade could be made if the problem of orderly marketing for agricultural products and natural materials could be taken in hand and developed. But here, again, increased credit resources would be required if the problem is to be dealt with effectively, combined with a cheap and effective system of cable transfers at par of exchange between the Central Banks of the Empire. The principle of preference duties would certainly have to be maintained, but where expedient they could be increased, and, wherever practicable, Free Trade could be established. The fundamental principle to be safeguarded in any such proposals would be the development of British agricultural production, and on such a basis as would give to the home agriculturists a fair return on their capital and labour; all excess food requirements only to be taken from the Dominions.

The first paragraph of the following two recommendations ably stated by the World Economic Conference,

Geneva, 1927, has been modified to suit my arguments :

> Agriculture is the occupation of the majority of workers throughout the world ; its varied products represent in value the greater part of human labour, and the exchange of its products against industrial products *forms, indeed, the basis of national trade, and ultimately of world trade.* The quantity of foodstuffs and raw materials produced by agriculture is one of the factors which determine the maximum limit of industrial development.
>
> The increase of agricultural production is a vital economic necessity, and, to this end, agriculture should be placed on an equal footing with industry so as to enable all those engaged in agriculture to obtain a satisfactory standard of living and a normal return for their labour and on their capital. It is important that this necessity should be brought home to public opinion, which does not always realise the true situation of agriculture, and too often regards it as an industry of independent and secondary importance.

Under a proper national monetary system, the industrialists of this country could afford to concede the principle that all those engaged in agriculture should obtain a satisfactory standard of living and a normal return for their labour and on their capital. Since 'cheapness' is a relative term, its efficacy will depend upon the relation which may exist between the volume of purchasing power and the food to be bought, and its general effect on costs of production. All wealth originates with the soil, and the more we produce in this way, the less we shall have to pay abroad. From the Budget surpluses which could thus be created, substantial remissions of taxation and debt could be effected. As this would reduce costs of production substantially, the question of whether agriculture should be developed should not depend on the price of the loaf. It should depend upon whether it would enable substantial reductions of debt and taxation to be made, and whether, as it must, it would be profitable to production and labour generally—which, in effect, means the country.

Broadly speaking, and from the country's point of view, agricultural production should be all profit to the country, which it cannot be under our present monetary system.

As taxation is largely shifted to costs of production, then it must impoverish the working classes by reason of the unemployment, and the diminution of the production of wealth, which ensues.

As taxation is largely shifted to costs of production, these will become national costs, and will rise or fall in accordance with the national Budget. If Government expenditure be high, costs of production will be high. If Government expenditure be low, then costs of production will be low. Substantial Budget surpluses will therefore be essential before costs of production can be lowered. From this argument it follows that the rise in the price of any given commodity does not affect costs of production, if a Budget surplus can thereby be assured. Similarly, a fall in the price of any given commodity will not lower costs of production, if a deficit is subsequently met by taxation. If the Budget deficit is not made good, inflation will ensue. If taxation is resorted to, in order to make good the deficit, costs of production will rise. Therefore, under a scientific monetary policy, of which Safeguarding forms an essential part, costs of production will not be affected by the variations in the price of commodities. They will be finally determined by the weight of taxation.

As national costs of production are not international costs, it will therefore be impossible for the producers of Great Britain to consent to any proposals that may lead to an international agreement to economise the use of gold, if such agreement means the stabilisation of the general level of world prices. The weight of taxation in Great Britain is much too high for any such proposal to receive even consideration. It is inconceivable that

the economists or the bankers of this country should wish permanently to saddle the producers of Great Britain with a permanent high costs level whilst a low costs level prevails in other countries. The figures of taxation per head of population on p. 62 will indicate the nature of this problem. The producers of this country should not be asked to accept a stable world price level. British producers should be allowed to recover their costs, whatever happens.

As costs of production have become national costs, then, unless we adopt Safeguarding, together with modern Central Banking practice, in order to promote the 'Dual System of Stabilisation,' Great Britain will continue to be a better country to sell in than to buy in. Without import duties for revenue, it would be impossible to assure bankers that they could extend credit on bills of exchange without risk, because all development programmes would be subject to foreign competition—in which case, the ideal of a gradually falling costs level could not be attained. If bankers have to extend credit on bills of exchange in accordance with modern Central Banking practice, then they have to take every reasonable precaution and receive every assurance that the bills will be redeemed at their due dates. This would not be possible if Great Britain continued to be a better market to sell in than to buy in, in consequence of the high costs level brought about by the weight of taxation, and which no conceivable increase of industrial efficiency could possibly wholly overcome.

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Printed in England at THE BALLANTYNE PRESS *by*
SPOTTISWOODE, BALLANTYNE & CO. LTD.
Colchester, London & Eton